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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71- 71-414

VULCAN MATERIALS COMPANY, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

OPINIONS BELOW

The opinion of the Court of Appeals is not yet officially reported.

It is unofficially reported at 27 AFTR 2d 71-1488 and at 71-1 USTC ¶ 9449. The opinion of the District Court is officially reported at 308 F.Supp. 53 and is

unofficially reported at 25 AFTR 2d 70-443 and at 70-1 USTC ¶ 9,189.

The date of the judgment sought to be reviewed and the time of its entry was May 28, 1971. A petition for rehearing was timely filed and was denied on June 25, 1971. The statutory provision believed to confer on this court jurisdiction to review the judgment in question by writ of certiorari is Title 28, Section 1254(1) U.S. Code (62 Stat. 928).

QUESTIONS PRESENTED

1. Whether the surviving corporation in a corporate merger should be denied the right to deduct its own net operating loss carryover because of the provisions of Section 269 of the Internal Revenue Code of 1954 where, after the merger, the stockholders of such loss corporation continued to own more than fifty percent of the outstanding stock of such surviving corporation?

2. Whether, upon the consummation of a corporate merger of a Delaware into a New Jersey corporation, the non-surviving Delaware corporation is entitled to deduct, as losses, pursuant to Section 165 of said 1954 Code, the unamortized expenses of organization and reorganization of itself and predecessor corporations not deductible in prior years?

3. Whether, upon the consummation of a corporate merger of a Delaware into a Delaware corporation, the non-surviving constituent corporation is entitled to deduct, as losses, pursuant to Section 165 of said 1954 Code, the unamortized expenses of organization and reorganization of itself and a predecessor corporation not deductible in prior years?

STATUTES INVOLVED

The federal statutes involved in this case are copied in the Appendices, pp. 30a-37a.[1] All are parts of the United States Internal Revenue Code of 1954 (the "1954 Code") and are Sections 63 (68 A. Stat. 18) and 161 (68 A. Stat. 45) and portions of Sections 165 (68 A. Stat. 49), 172 (68 A. Stat. 63), 269 (68 A. Stat. 80), 381 (68 A. Stat. 124), and 382 (68 A. Stat. 129), all as they existed in 1954 and in 1957, respectively. Sections 381 and 382 are not deemed to be directly involved, but may have to be consulted in aid of the construction of Sections 172 and 269, in the aspects here involved. Portions of the laws of the State of New Jersey, Delaware and Illinois which are deemed to be relevant, are copied on pp. 21a-27a, 29a and 30a.

STATEMENT OF THE CASE

The facts which we believe are relevant to the questions above are stated below. Except as hereafter shown, all the facts were stipulated, p. 3a.

By this petition, the petitioner seeks to have this Court review the decisions of the Court of Appeals for the Fifth Circuit in two cases in both of which the petitioner was the appellant. They were numbered 30,116 and 30,117, respectively, in the Court of Appeals and are so designated herein.

The petitioner (hereafter generally called "Vulcan") is a corporation organized under the laws of New Jersey[2] and is the surviving corporation in a series

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[1] Page references followed by "a" are to pages in the appendices.

[2] The opinion of the Court of Appeals does not disclose that Vulcan is a New Jersey corporation, though the fact could control the decision. It is shown in the opinion of the District Court, 308 F.Supp. 54.

of corporate statutory mergers which were consummated as follows: Effective December 31, 1953, the Consumers Company ("Consumers") and Frontier Chemical Company ("Frontier"), both Delaware corporations, were merged into Follansbee Steel Corporation ("Follansbee"), also a Delaware corporation, under the laws of Delaware. Follansbee was the corporation surviving such merger, pp. 44a, 54a. In the course of this merger, the "1953 merger," Follansbee's name was changed to Union Chemical & Materials Corporation, and it is hereinafter sometimes referred to as Follansbee-Union Chemical. This is the "1954 merger."

On December 31, 1957, Follansbee-Union Chemical and Lambert Brothers, also a Delaware corporation, merged into Vulcan under the laws of Delaware and New Jersey, with Vulcan as the surviving corporation. This is the "1957 merger." Each of the above-mentioned mergers constituted a reorganization within the meaning of Section 368 (a) (1) (A) of the 1954 Code.

Throughout this petition, we use the term "merger" in what we understand is the technical sense. Paraphrasing the definition by the Court of Appeals, a statutory merger effects a combination of two or more corporations, "with the of the corporations sur-

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[1] In several expressions the opinion of the Court of Appeals may appear to indicate that Follansbee-Union Chemical was not the same corporation as Follansbee. But as the Court of Appeals calls the transaction a "merger" and in its definition of a statutory merger says that "one of the corporations continues as the same entity it was before the transaction" (p. 7a), the opinion apparently properly refers to Follansbee-Union Chemical as "the surviving corporation." (pp. 4a, 7a).

tinuing as the same legal entity it was before the transaction," p. 7a.

Each of these cases involved an appeal from a judgment of the District Court for the Northern District of Alabama (Southern Division) in an action by Vulcan against the United States for the recovery of income taxes paid by Vulcan, or a predecessor thereof, in respect of the income tax liability of a predecessor in the series of mergers described above. In each case, jurisdiction of the District Court was invoked under Section 1346(a) of Title 28 of the United States Code (62 Stat. 939). The right of the petitioner to maintain these actions was not challenged and, in respect of any tax paid by a predecessor, is supported by *Seaboard Airline Railway* v. *U. S.*, 256 U.S. 655 (1921).

These cases were originally designed to procure deductions of organization and reorganization expenses upon the consummation of each of the 1954 and 1957 mergers, hereafter called only "organization expenses." The plainer case appears to be presented with respect to the 1957 merger, for there Delaware corporations were merged into a New Jersey corporation. However, in order to defeat the claim with respect to the 1957 merger, the Government denied the net loss carryover. Therefore, this issue must also be considered by the Court.

No. 30,116 involves the income tax liability of Consumers for its taxable year which began on January 1 and ended on December 23, 1954, the effective date of its merger into Follansbee-Union Chemical. This case presented only the question of the deductibility of organization expenses of Consumers and its predecessor. No. 30,117 involves the income tax liability

of Follansbee-Union Chemical for its taxable year which began on March 1, 1957, and terminated on December 31, 1957, the effective date of the merger into Vulcan, its "taxable year 1957." No. 30,117 involves what is herein called the "net loss issue," and also issues respecting the deductibility of organization expenses of Follansbee and its predecessor, Follansbee Brothers Corporation, and such part of the organization expenses of Consumers as are not allowable as deductions in No. 30,116.

While the cases constituted separate suits, they were consolidated for trial and hearing in the District Court and for oral argument in the Court of Appeals, and a single opinion was rendered in each court. If the deduction of the organization expenses of Consumers is denied in No. 30,116, they may be allowable as deductions in No. 30,117. The facts that the deductibility of organization expenses upon the consummation of a statutory merger is involved in each of Nos. 30,116 and 30,117 and that those of Consumers may be allowable in either case are the occasion for seeking review of both thereof by this petition. This procedure is permitted by paragraph 5 of Rule 23.

There was no oral testimony, but there were only stipulations and exhibits. One of the exhibits was the notice of the special meeting of the stockholders of Follansbee called to be held on October 27, 1957, and the Proxy Statement attached thereto. The others were a copy of the 1957 merger agreement and a certificate by the Secretary of State of New Jersey that, in the 1957 merger, Vulcan did not procure any credit for any fees paid to the State of Delaware by either Follansbee-Union Chemical or Lambert Brothers.

The Net Loss Issue

Vulcan could recover in No. 30,116 for 1954 even though it loses on the net loss issue in No. 30,117, but it is not entitled to recover in No. 30,117 if it should lose that issue. As the result of operations and the sale of operating assets, Follansbee incurred a net operating loss of some $6,000,000 in its taxable year that began January 1, 1954. Carrybacks to prior years were allowed as deductions under Section 172 of the 1954 Code. The remaining portion of the 1954 net operating loss was deducted by Follansbee-Union Chemical as carryovers to later taxable years. The final portion was originally allowed as a deduction for the taxable year 1957, but was disallowed in the denial of the refund claim. This is the only deduction which is challenged in reliance on Section 269 of the 1954 Code.

Under the contract for the sale of Follansbee's operating assets, and after deduction of expenses and a cash refund, and provision for additional expenses, losses, etc., Follansbee-Union Chemical was left with net current or liquid assets in the sum of approximately $8,500,000. Follansbee's Controller estimated its tax loss carryover at $4,700,000 and the value thereof at $2,300,000. Certain exchange ratios were suggested by him. These were followed in the 1954 merger agreement, with the following results.

The stockholders of Follansbee retained the 464,469 shares of its common stock which they owned immediately prior to the merger and received the same number of shares of Follansbee-Union Chemical's 5% Cumulative Preferred Stock of the par value of $5.00 per share. This was the entire issue thereof, and it

was limited as to voting power. All that the stockholders of both Consumers and Frontier together received initially, and later, as a result of the merger, was the total of only 449,195 shares of Follansbee-Union Chemical's common stock.

Thus, those who were the stockholders of Follansbee immediately before the 1954 merger continued to own more than 50% of each of the voting stock and of the fair market value of all outstanding stock, of the single corporate taxpayer, Follansbee-Union Chemical, that was outstanding immediately after the consummation of the 1954 merger. The Court of Appeals treated the interest of the old Follansbee-Union Chemical stockholders as being 57% of the whole, to which we take no exception, e.g., pp. 11a, 14a.

In its dealing with the requirements of Section 269 that the "principal purpose" of the transaction described in either clause (1) or (2) is the "evasion or avoidance of Federal income tax," the Court of Appeals concluded that Follansbee had converted its assets to cash at some time before the stockholders' meeting and made other comments with respect to the relationship between the sale of Follansbee's assets and the merger. The first statement is altogether incorrect, and some comments are either erroneous or misleading. These errors are not presented as a direct issue and therefore the demonstration thereof is shown only at the end of the appendices (p. 44a).

Organization Expense Issues

The amount claimed in No. 30,116 for 1954 in respect of the organization expenses of Consumers is $168,890.91, with interest paid and allowable. Vulcan itself paid most of this tax, but some had been paid

by Follansbee-Union Chemical, as transferee of Consumers.

From 1933 through 1937, various expenditures were made by Consumers (called "Delaware" in the stipulation) and its predecessor (called "Illinois" therein) with respect to the reorganization of the predecessor under Section 77(b) of the Bankruptcy Act and the organization of Consumers. Each expenditure was capital in nature and not deductible when paid or incurred. Each item and a brief description thereof were stipulated. The total was $293,712.77. They included payments to the trustees in bankruptcy, committees for creditors, and stockholders, and their counsel and the amounts paid to the persons or firms named in respect of the items which are copied on p. 43a, ff.

The Court of Appeals thought that the $3,209.34 paid to the Secretary of State of Illinois was not sufficiently identified as the expense of qualifying Consumers to do business in Illinois, but stated that such an expense might be deductible, footnote 4, p. 9a.

Relevant portions of the 1957 Merger Agreement provide, in part, that Vulcan, "The Surviving Company shall be governed by the laws of the State of New Jersey," and, after reference to the Delaware statutes, that: "Thereupon, the said corporations shall be one corporation, which shall be Vulcan, and the separate existence of Union (i.e., Union Chemical) and Lambert shall cease."

In addition to any organization expenses that are not allowed in No. 30,116, Vulcan claims the following described Follansbee organization expenses. Follansbee Brothers Company, predecessor of Follansbee, was

a corporation organized under the laws of Pennsylvania. Follansbee was organized on March 29, 1937, to effect the plan of reorganization of such predecessor in proceedings under Section 77(b) of the Bankruptcy Act then in effect. Follansbee assumed payment of all liabilities and obligations of Follansbee Brothers Company not affected by the plan of reorganization. These included all allowed expenses of reorganization and administration.

The amounts of the organization and reorganization expenses so paid are shown in Sched. II to the complaint and aggregated $307,230.50. $8,474.03 thereof represented expenses for listing Follansbee's stock on the New York Stock Exchange. In addition to compensation for the trustees in bankruptcy and their counsel, such expenses also included compensation for committees representing bondholders, unsecured creditors, preferred and common stockholders and their counsel. In 1946, the Sheet Metal Specialty Company was merged into Follansbee, and the latter incurred expenses of $10,237.85 and of $22,297.82 relating thereto.

The bases of the assets of Follansbee Brothers Company and of Sheet Metal Specialty Company constituted the bases of such assets in the hands of Follansbee. None of said expenses was deductible when paid or incurred, but all were required to be capitalized on Follansbee's books.

REASONS FOR GRANTING THE WRIT

NET LOSS ISSUE

1. In denying to Follansbee-Union Chemical, a single corporate taxpayer, from prior to January 1, 1954 through 1957, a deduction for part of a net operating loss sustained by it in its taxable year that began on January 1, 1954, notwithstanding that control of its stock was not acquired by any person, within the contemplation of Section 269 of the 1954 Code, the decision of the Court of Appeals in this case on the net loss issue is in direct conflict with the decision of the Court of Appeals for the Ninth Circuit in Maxwell Hardware Co. v. Commissioner, 343 F.2d 713 (9th Cir., 1964), on an important recurring question of federal law, and is basically inconsistent with one of its own decisions, with several decisions of this Court, including Central R.R. & Bkg. Co. v. Georgia, 92 U.S. 665 (1876), and with a decision of a District Court from which no appeal was taken.

The decision adverse to Vulcan on the net loss issue was, in terms, based solely upon the application of Section 269 of the 1954 Code. This necessarily carried the implication that Section 172 of that Code would otherwise authorize the deduction (pp. 13a-16a).

In *Maxwell Hardware Company* v. *Commissioner,* 343 F.2d 713 (9 Cir. 1964), two individuals acquired, for cash, non-voting preferred stock in a loss corporation, which entitled them to participate in the benefit of the net loss carryover. The value of the preferred stock was less than the value of stock retained by its former stockholders, so that the new stockholders did not acquire "control" of the loss corporation, as defined by Section 269(a). The loss corporation thereafter engaged in a business different from that conducted by it when the losses were incurred, and such new business produced the income sought to be taxed.

The Ninth Circuit then held that the loss corporation was entitled to take the net operating loss deduction, notwithstanding the provisions of Section 269, held that Section 382(a) did not apply, and refused to apply the rationale of *Libson Shops* v. *Kochler,* 353 U.S. 382 (1957) to a case arising under Section 172 of the 1954 Code. But, in the case at bar, neither Section 382(a) nor *Libson Shops* was relied on by the Court of Appeals or the District Court. See pp. 13a and 14a.

In this case, the stockholders of Follansbee-Union Chemical retained more than 50 percent of its common stock, and received all of its preferred stock. The Court of Appeals called this total 57% of the stock. The preferred stock was issued in order to give them the estimated value of the net loss carryover. This should preclude the application of Section 269(c) of the 1954 Code.

So, contrary to the principle applied in *Maxwell Hardware,* the single corporate taxpayer which was the surviving corporation in the 1954 merger, Follansbee-Union Chemical, was denied its own net operating loss carryover for its taxable year 1957, although "control," thereof as defined in Section 269, was not shifted. This definition reads:

> "For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock of the corporation."

The basic conflict between the decision in this case and that in *Maxwell Hardware* lies in the fact that

the latter case requires a change in the ownership of stock which would effect a shift in what we shall call "stock control" while the Court of Appeals, in this case, held, implicitly, that no such change was required. This resulted, primarily, from the treatment of the acquisition of the properties of a corporation as the acquisition of control thereof, notwithstanding the foregoing definition of control.

Indeed, here we have an application of clause (1) rather than of clause (2) of Section 269(a), although it was recognized that clause (2) was the one at issue, p. 10a. The conclusion that there was a shift in the "ownership of a profitable corporation" and therefore of control was rested solely on the acquisition of the properties, not stock, of Consumers and Frontier, e.g., pp. 15a and 16a. A further statement respecting this error is found in the discussion of Reason 3.

In *United States* v. *Jackson Oldsmobile, Inc.*,[4] 371 F.2d 808 (5 Cir. 1967), the Fifth Circuit also gives effect to the same policy respecting the necessity for a change in stock control, for there was about a 40% change in ownership of the net loss carryover. The Court of Appeals distinguished this case on the ground that there was no change in business, p. 14a. But *Maxwell Hardware* treats a change in business as immaterial when there is no shift in stock control, and examination of Section 269 shows that it is indeed irrelevant.

The decision in the case at bar is also in essential conflict with the rationale of several cases decided by

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[4] This decision is erroneously called *United States* v. *Jackson Automobile, Inc.*, on page 14a.

this Court involving exemptions of corporations from various types of state taxation. In those cases, the surviving corporation in a merger has been held to be entitled to its own tax exemptions, notwithstanding the addition of stockholders pursuant to the merger, and a resulting change in the beneficial ownership of the exemptions. The cases include *Central R. R. & Bkg. Co.* v. *Georgia,* 92 U.S. 665 (1876), *Wright* v. *Georgia R. & Bkg. Co.,* 216 U.S. 420 (1910) and *Redwine* v *Georgia Ry. & Bkg. Co.,* 344 U.S. 925 (1953). Other cases are cited in the opinions in those cases. A deduction is not entitled to any more favorable treatment than an exemption. *Central R. R. Co.* v. *Georgia* is also an important authority on the organization expense issues.

There is confusion in rulings, and press releases, by the Commissioner relating to the extent to which this Court's decision in *Libson Shops* is effective under the 1954 Code, and this confusion is illustrated by the decision of the Court of Appeals below. Unless the case at bar is an exception, all the cases which have considered the question, including *Jackson Oldsmobile, Maxwell Hardware* and *WOFAC Corporation* v. *U. S.,* 269 F.Supp. 654 (D.C. N.J., 1967), concur in concluding that a change in business alone, of a single corporate taxpayer, not accompanied by a shift in "stock control," is not significant under Section 172, and is to be taken account of only if required by Section 382 of the 1954 Code. This confusion should be eliminated by this Court as we undertake to show below.

No appeal was taken from the decision in *WOFAC Corporation.* The treatment of T.I.R. 773 in the opin-

ion of the Court of Appeals on page 15a and in footnote 9, page 13a, is inadequate. The Release is cited at the end of the concurring opinion in *Jackson Oldsmobile* to sustain the position which we assert, namely that Section 269 in this context proscribes only a shift of as much as 50% of the beneficial interest in the net loss carryover. (371 F.2d 809) The Release is copied on pp. 37a-39a.

2. The Court of Appeals has decided an important question of federal law respecting the application of Sections 172 and 269 of the 1954 Code which has not been, but should be, settled by this Court, and the substance of which was left undecided in Libson Shops, Inc. v. Koehler, 353 U.S. 382.

This reason corresponds with the reason assigned for granting the writ in *Libson Shops,* 353 U.S. 384. However, that decision left undecided several questions which are presented in the case at bar, and it applied Section 122 of the 1939 Code, while we are concerned here with Section 172 of the 1954 Code. While both deal with net operating loss deductions, there are material differences in the two sections and codes, as conceded in footnote 2 to the opinion in *Libson Shops,* 353 U.S. at 384. We use the expression "single corporate taxpayer" because, in footnote 9 to *Libson Shops,* this Court said:

> "We do not pass on situations like those presented in Northway Securities Co. v. Commissioner, 23 B.T.A. 532; Alprosa Watch Corp. v. Commissioner 11 T.C. 240; A. B. & Container Corp. v. Commissioner, 14 T.C. 842; WAGE, Inc. v. Commissioner, 19 T.C. 249. In these cases, a *single* corporate taxpayer changed the character of its business and the taxable income of one of its enterprises was reduced by the deductions or credits of another." (353 U.S. 390)

Originally, the Commissioner acquiesced in all three decisions. Those acquiescences were later withdrawn and the decisions in *Algoma Tube* and *A. E. C. Container Corp.* have been subsequently reversed because control of the loss corporation was shifted. However, the decisions in *Maxwell Hardware* and *WAGE, Inc.* are in accord with the present view of the Commissioner respecting the application of Section 269(a)(1) of the 1954 Code as set forth in Rev. Rul. 63-40, 1963-1 C.B. 45, and in Treasury Information Release 773. They are also in accord with the decision of the Fifth Circuit in *Libson Shops, Inc. v. Koehler*, *supra*, and *Oldsmobile, Inc.* The concurring opinion in Oldsmobile, 1963 T.I.R. 773, 371 F. 2d 449.

However, examination of Section 269 will indicate that a change in business is not material, and that the occasion for consideration of that matter in *Libson Shops* and *Oldsmobile* was this Court's decision in *Libson Shops*. In *Libson Shops*, this Court did not consider the effect of Section 129 of the 1939 Code, predecessor of Section 269 of the 1954 Code, but based its decision on Section 122 of the 1939 Code. The Government's reliance by the Court of Appeals in Section 269 carries the implication that the net loss carry-over would be otherwise available under Section 172, and that court seems to have been unaware of the possible inconsistency. The confusion which would result is eliminated by this Court.

3. The decision of the Court of Appeals in this case on the net loss issue fails to apply the statutory definition of "control" which is found in Section 269(a) of the 1954 Code, in deciding an important question of federal law and this is in conflict with decisions of this Court that require adherence to statutory definitions, such as 62 Cases of Jam v. United States, 340 U.S. 593, and United States v. An Article of Drug, 394 U.S. 784. In doing so, the Court of Appeals also failed to observe the distinction between the stock and property of a corporation and this failure is in conflict with applicable decisions of this Court, such as Central R. & Bkg. Co. v. Wright, 164 U.S. 327.

As noted, Section 269(a) of the 1954 Code contains this definition of what we call "stock control":

> "For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock of the corporation." (p. 32a)

We submit that the Court of Appeals did not follow this statutory definition of control, although, at one point, it speaks of the acquisition of a "controlling stock interest in the corporation," (p. 11a) and at another, it says that the inquiry is whether "there has been an acquisition of control as contemplated by Section 269 . . .." (p. 13a). However, the first of these recognitions of the issue is qualified by the statement in footnote 9 that the question is not the "*amount* of stock ownership change, but the *effect* of the change upon control." This is squarely contradictory of the statutory definition, and therefore conflicts with this Court's decisions of the import that statuory definitions shall govern in the construction of a statute. *62 Cases of Jam* v. *United States,* 340 U.S. 593, 596 (1951), and *United States* v. *An Article of Drug,* 394 U.S. 784 (1969).

Instead of following the statutory definition, the opinion in the Court of Appeals treats the acquisition of the *properties* of Consumers and Frontier as involving what is said to be at one place "a substantial change in the ownership of a profitable corporation," (p. 14a). Again, it is said, ". . . there was a shift of 57 percent of the ownership of a profitable corporation." This is followed by the statement that, ". . . considering solely the question of 'control,' we are persuaded that there was an acquisition of the control, under section 269, of profitable corporations. . . ." Again, the Court of Appeals speaks of "Follansbee's acquisition of the chemical and buildings materials companies . . . ." (p. 16a)

Thus, the Court of Appeals fails to observe the well defined distinction between the stock of a corporation and its properties. That Congress intended for its definition of stock control to govern all decisions under Section 269(a) is further shown by the fact that clause (2) thereof deals specifically with the acquisition of property, through the merger process (and possibly others) (p. 32a). Thereby, it necessarily excludes the application of the "stock control" test to an acquisition of corporate property rather than corporate stock. This failure conflicts with the rationale of several cases in this Court, of which *Central R. R. and Banking Co.* v. *Wright,* 164 U.S. 327 (1896), is an instance.

The stipulation of the issues included one as to whether the 1954 net operating loss of Follansbee and "one incurred by Union Chemical in the taxable period January 1 to February 28, 1955, are allowable under Sections 172 and 269(a)(2) in those periods and in taxable years of Follansbee preceding such periods, and subsequent taxable years of Union Chemical . . ." Thus,

the stipulation called for a decision under clause (2), while the Court of Appeals rested its conclusion upon an acquisition of control under clause (1). A corresponding limitation of the issues was included in the amended pre-trial order.

That there was such a limitation of issues is adequately shown in the opinion in the District Court which is directed towards Section 269(a)(2). (308 F. Supp. 56, 58, 59.) The opinion of the Court of Appeals also undertakes to deal with clause (2), apparently without recognition of the fact that it involves the acquisition of property of a corporation in a non-taxable reorganization, such as a statutory merger, and not with the acquisition of "stock control" thereof. One obvious effect of the stipulation is a concession by the Government that there had been no shift of control within the contemplation of clause (1). It has not been suggested that the stipulation was improvidently entered into so as to relieve the Government of the burden of its commitment. In such a case, the stipulation should be observed, *General Utilities & Operating Co.* v. *Helvering,* 296 U.S. 200 (1936).

The main reliance of both courts in arriving at these conclusions was the decision in *Southland Corporation* v. *Campbell,* 358 F.2d 333 (5 Cir., 1966). In that case, however, a loss corporation, Caribbean did acquire "stock control" of a profit corporation, Old Cabell's, and it was therefore possible to invoke clause (1). Actually, the opinion in *Southland Corporation* contains useful statements of the import that Section 269 "is applicable only in certain carefully circumscribed situations," followed by recognition that there must be not only a shift in stock control, but also the proscribed purpose. 358 F.2d at 336. All of these facts are noted in the opinion (p. 12a, including footnote 8).

ORGANIZATION EXPENSE ISSUES

4. The availability of a deduction for organization expenses in consequence of the 1957 merger presents an important recurring question of federal law, on which the decision of the Court of Appeals is in conflict with the decision of this Court in Marr v. U.S., 268 U.S. 536, in essential conflict with the decision of the Court of Appeals for the Fourth Circuit in Fidelity Baltimore National Bank v. U.S., 328 F. 2d 953, and decisions of other Courts of Appeals and in essential conflict with a decision of a District Court from which the United States did not appeal.

In view of decisions of three Courts of Appeal, the Court of Claims, and decisions of the Board of Tax Appeals in which the Commissioner of Internal Revenue ultimately acquiesced (some cited below), the Government conceded, in the Court of Appeals, that organization and reorganization expenses of the nature here involved may be deducted "upon the dissolution and liquidation of a corporation" (p. 6a). The Court of Appeals also recognized that the "separate existence of all the constituent corporations . . . except the one into which the other or others of such constituent corporations have been merged" ceased, under the controlling provisions of the Delaware statute, 8 Del. Code Anno. 259(a) (p. 7a confirmed on p. 8a). The full text of this section of Delaware law is copied on p. 26a.

Therefore, we forego citing any of the numerous cases that hold to that effect except some that are also relevant to other phases of the cases, such as *Central R. R.* v. *Georgia,* 92 U.S. at 672 and 674. The Court of Appeals then undertook to show that there was a difference between the termination of corporate existence which follows dissolution and that which follows merger. That Court said,

> "In a dissolution, the privileges, *powers, rights* and duties of the corporation come to an end and

> suffer a corporate death. In a merger, these attributes of corporate life are transferred to the surviving corporation and are there continued and preserved." (p. 8a, emphasis supplied)

In spite of this fairly clear statement and of the implications of the quotation from the Delaware statute, the Court of Appeals includes a quotation from Fletcher, Cyclopedia of Corporations (Perm. Ed.) which does not make it clear that the corporate life of the non-surviving constituent corporation is terminated, and that it is dissolved (p. 7a, quoting from 15 Fletcher, Cyclopedia of Corporations § 7041). Fletcher contains inconsistent statements about the effects of mergers and consolidations and is not, therefore, wholly reliable. In Section 7079, there is an unequivocal statement that supports the position which we advance in respect of this effect of a corporate merger under statutes like the Delaware statute:

> "The statute may be so worded as to leave one or all of the constituent corporations in existence, at least for a limited time, or it may expressly or impliedly provide for the absorption of one company by the other, the *former going out of existence* and the latter remaining in existence, which constitutes a merger rather than a consolidation; . . . ." (15 Fletcher 94-5, emphasis supplied)

While the opinion of the Court of Appeals shows that Follansbee-Union Chemical was a Delaware corporation, it does not disclose that Vulcan, the survivor in the 1957 merger, is a New Jersey corporation (p. 4a). So there is no independent discussion of the significance of that fact.

The foregoing statement of the assumed effects of a merger are in direct conflict with the decision of this Court in *Marr* v. *U.S.*, 268 U.S. 536 (1925). This in-

volved a change in the domicile of a New Jersey corporation to Delaware through acquisition of stock by the Delaware corporation and dissolution of the New Jersey corporation. In holding that this gave rise to taxable income prior to the adoption of statutes which do not tax profits realized in reorganizations of that character, this Court said, "In the case at bar, the new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same *rights* and *powers* as one organized under the laws of New Jersey." (268 U.S. 541, emphasis supplied)

Plainly, the result reached by the reorganization process involved in *Marr* is the same as would have been reached by a statutory merger of a New Jersey into a Delaware corporation. *Central R. & Bkg. Co.* v. *Georgia,* 92 U.S. at 673, copied in the argument. There were also some changes in relative stock ownerships which led this Court to observe that the stockholders of the New Jersey corporation did not have "the same proportional interest of the same kind in essentially the same corporation." (268 U.S. 541)

Obviously, this is true in the case of the 1957 merger of Union Chemical into Vulcan and of mergers generally. Plainly, the stockholders of Follansbee-Union Chemical wound up with a stock interest in a corporation which was totally different from their prior stock interest in a different corporation owning different assets. The first of the foregoing statements in the opinion in *Marr* is expressly relied on in two decisions involving the imposition of stamp taxes, namely, *U.S.* v. *American Vortex Cup Co.,* 84 F.2d 925, 927 (7 Cir., 1935), and *Jefferson Lake Sulphur Company* v. *U.S.,* 195 F.2d 1012, 1015 (5 Cir., 1952).

Essentially the same conclusions were reached in *Fidelity Baltimore National Bank* v. *United States,* 328 F.2d 953 (4 Cir., 1964), involving liability for stamp transfer taxes on the "consolidation" of a state bank with a national bank under the charter of the latter. This was found to be essentially a merger. The Fourth Circuit expressly commented on the difference in jurisdictions involved, 328 F.2d at 956-7.

Marr and *Fidelity-Baltimore* dispose of the questions of transmission of "rights" and "powers." But it is equally plain that corporate "duties" are not transmitted to the surviving corporation organized in another state, at least to any greater extent than in the case of any other assumption of liabilities. For example, Vulcan is not obligated to pay Delaware franchise taxes. It has its own "duties," and so did Follansbee-Union Chemical after the 1954 merger. In *Fidelity Baltimore,* the Fourth Circuit noted that the merged corporation does not file income tax returns, 328 F.2d at 958.

Aside from the Fourth Circuit in that case and the Fifth Circuit in *Jefferson Lake Sulphur Co.,* which may not have involved a statutory merger, Courts of Appeals of three other circuits have imposed stamp transfer taxes on the non-surviving constituent corporation in a corporate merger, namely *U. S. Industrial Chemicals Inc.* v. *Johnson,* 181 F.2d 413 (2 Cir. 1950); *American Processing & Sales Co.* v. *Campbell,* 164 F.2d 918 (7 Cir., 1947), cert. den. 333 U.S. 844 and *Emporium Capwell Co.* v. *Anglim,* 140 F.2d 224 (9 Cir., 1944) cert. den. 322 U.S. 752. These were based on the essential nature of a statutory merger, namely that the assets of the non-surviving constituent (generally,

and hereafter called the "merged corporation") are transferred to the surviving corporation in consideration of the issue of stock of the latter, and the assumption of the former's liabilities.

These, and other cases, necessarily proceed on the assumption that the corporate existence of the merged corporation is terminated and that its franchise to be a corporation is not transferred. Two other cases in other circuits that proceed on the same hypothesis are cited because they involve Delaware corporations, *Koppers Coal & Transportation Co.* v. *U.S.*, 107 F.2d 706 (3 Cir., 1939), and *Jones* v. *Noble Drilling Co.*, 135 F.2d 721 (10 Cir., 1943).

Finally, in *Dragon Cement Co.* v. *U.S.*, 144 F. Supp. 188 (D.C. Me., 1956), an organization expense was expressly allowed as a deduction, and it is in direct conflict with the decision in the case at bar. While the Government appealed from this adverse judgment, it was only on another aspect of the case. *United States* v. *Dragon Cement Co.*, 244 F.2d 513 (1 Cir., 1957). This conflict and the fact that this issue presents a recurring problem in the law of federal income taxation should influence this Court to review these cases on this issue.

The decision in *Dragon Cement* appears to have been the reason why the District Court thought that expenses of qualifying to do business in Illinois might be deductible and for what may have been a similar concession by the Court of Appeals. (308 F. Supp. 58, 59, p. 9a, f.n. 4) The Court of Appeals summarized its conclusions with the statement that the "capital assets" here involved "were not *lost*, but were continued beyond the corporate existence of the constituent corporations and

persisted as capital assets of the surviving corporation" (p. 9a, emphasis supplied).

We submit that this conclusion is essentially incorrect as to certain other items of expense such as those involving the capital structure, and is not in accord with applicable decisions. Of these, the most significant are *Union Chemical & Materials Corp.* v. *Cannon,* 38 Del. Ch. 203, 148 Atl. 2d 348 (Del. Sup. 1959); *Central R. Co.* v. *Georgia;* and *Rochester R. Co.* v. *Rochester,* 205 U.S. 236 (1907). However, since the question also arises in the case of the 1954 merger, we discuss it in that connection. So also with the effects of the correspondence of the "end result" in the case of a corporate merger and a "C" type reorganization. The quoted words come from the opinion in *American Processing and Sales Co.,* 164 F.2d at 920.

The predicates on which the stamp tax cases are decided establish that there is a liquidation as well as a dissolution of the merged corporation. Since it supplies the consideration, it is entitled to the rights to the stock of the surviving corporation and, in effect, transfers them to its stockholders. By having this stock issued to its stockholders, it divests itself of all of its assets upon the consummation of the merger and thus effects the substance of a liquidation concurrently with its dissolution. Cf., *Rochester R. Co.* v. *Rochester.*

In the final analysis, the decision below is rested on the decision in *Citizens Trust Co.* v. *Commissioner,* 20 B.T.A. 392 (1930), which is cited in the opinions of both the Court of Appeals and the District Court (308 F. Supp. 56, and p. 9a). In the argument, we undertake to show that this case is based on a misconception of the law of New York.

5. The decision of the Court of Appeals in this case on the organization expense issue involved in the 1954 merger is in essential conflict with the rationale of several decisions of other Courts of Appeals, including that of the Seventh Circuit in American Processing and Sales Co. v. Campbell, 164 F. 2d 918, and derivatively, with this Court's decision in Raybestos-Manhattan, Inc. v. United States, 296 U.S. 60 and with that of the United States Tax Court in Kingsford Company v. Commissioner, 41 T.C. 646, in which the Commissioner has acquiesced.

Here, we are primarily concerned with the essential nature and effects of a corporate merger described above, but deal only with a single state. It is not important that the stock is issued direct to the stockholders of the merged corporation. Cf., *U.S.* v. *Vortex Cup Co.* and *Raybestos-Manhattan, Inc.* v. *U.S.*, 296 U.S. 60 (1935).

What is important is that, in the process, the stock of the merged corporation ceases to have any intrinsic value, just as in the case of the stock of a dissolved corporation that has completed its liquidation. This is due to the fact that the stock of the merged corporation ceases to represent an interest in property, since not only is it dissolved, but also the transferable property of the merged corporation has vested in the surviving corporation. Therefore, it is the stock of the latter corporation which evidences interests in that property and, of course, in its own retained property.

So, the value of expenditures related to the issue of stock of the merged corporation is "lost," the criterion applied by the Court of Appeals in this case (p. 9a). Such expenditures create what may be called the "capital structure" of the merged corporation. This capital structure is not continued beyond the corporate existence of the merged corporation, and therefore does

not persist as a capital asset of the surviving corporation, as required by the Court of Appeals (p. 9a).

That such is the case is, we submit, conclusively established by the decision of the Supreme Court of Delaware in *Union Chemical* v. *Cannon, supra,* since it considered the effect of the 1957 merger on the stock of Union Chemical. The Delaware Supreme Court held that the shares of Union Chemical were "automatically converted into shares of Vulcan" and so could no longer support jurisdiction by attachment (38 Del. Ch. 206, 209, 148 Atl. 2d 351). The effect on the shares of capital stock of the mergers there involved were significant influences in the decisions of this Court in *Central R. R.* v. *Georgia,* 92 U.S. at 672 and *Rochester R. Co.* 205 U.S. at 256. In the latter case, it was said that dissolution resulted because the corporation was left "without stock, officers, property or franchises."

Certain specific expenditures relating to the original issue of the capital stock of Consumers, the value of each of which was surely lost upon the consummation of the merger of Consumers into Follansbee-Union Chemical, are listed beginning at page 43a of the appendices. In addition to those, the compensation of committees for creditors or stockholders, of counsel therefor, and for individual creditors or stockholders, and certainly the bulk of the compensation for the trustees and their counsel related to the creation of the capital structure of Consumers which was obliterated by its merger into Follansbee-Union Chemical. Therefore, the value thereof must have been "lost" upon the consummation of that merger.

If because both of these were Delaware corporations, the deduction is not available but would be available upon the merger of Follansbee-Union Chemical into

Vulcan, then the reasoning stated above would also be applicable. The foregoing reasoning is also applicable to the reorganization expenses of Falkenau Brother Company and of Falkenau Metals, which were involved in the 1957 merger.

The organization expenses should be also allowed as a deduction in the case of the 1956 merger because a statutory merger accomplishes the same "end result" as does a "C" type reorganization in which the transferee assumes the liabilities of the transferor and the transferor is promptly liquidated. A "C" type reorganization is defined in paragraph (C) of section 368(a)(1) of the 1954 Code and involves essentially "the acquisition by one corporation in exchange solely for all or a part of its voting stock of substantially all of the properties of another corporation," which may be forthwith distributed. In *Commissioner* v. *Commissioner*, 41 T.C. [illegible] (1964), 1964-1 Cum. Bul. 6[illegible], the deduction of organization expenses was allowed in a "C" type reorganization. This was true also in the case of *Pacific Coast Biscuit Co.* v. *Commissioner*, 32 BTA 30[illegible] (1935), 1935-1 Cum. Bul. 19[illegible]. The latter is one of the cases which the Government conceded was correctly decided [illegible].

The decision in one of the stamp tax cases, *American Processing & Sales Corporation*, was in part specifically rested on the proposition that since the "end result" of a statutory merger was the same as the procedure involved in *Bayberry Corporation, Inc.*, the stamp tax consequences should be the same. The Court said on this subject:

> "Forms are not important. It is the end result that counts. The end result is the same in both cases." (164 F.2d at 920)

Raybestos Manhattan, Inc. involved what was, in fact, a "C" type reorganization in which the assets of one corporation were transferred to another with the stock of the transferee being issued direct to the stockholders of the transferor. Therefore, we urge that the decision of the Court of Appeals is essentially in conflict with that decision of this Court.

6. The decision of the Court of Appeals involves important recurring questions of federal law relating to the deductibility of expenses of organization and reorganization upon the consummation of a statutory merger of one corporation into another which have not been, but should be, decided by this Court.

Although the adoption of Section 248 of the 1954 Code may reduce the amount of organization expenses which may be claimed as a deduction upon the consummation of a statutory merger, this statute is not deemed to apply to reorganization expenses. Nor does it apply to any organization expenses which were incurred before the adoption of the 1954 Code. Therefore, the question of the deductibility of organization and reorganization expenses of the non-surviving constituent corporation will arise upon the consummation of most, if not all, statutory mergers.

Either as the result of a decision by a Court of Appeals, as in *Bryant Heater Company* v. *Commissioner,* 231 F.2d 938 (6 Cir., 1956), and *Gravois Planing Mill* v. *Commissioner,* 299 F.2d 199 (8 Cir., 1962), or by the Court of Claims, as in *Koppers Company, Inc.* v. *U.S.*, 278 F.2d 946 (1960), or of acquiescence by the Commissioner, as in *Kingsford Company,* taxpayers have been allowed deductions for the organization and reorganization expenses in other types of non-taxable exchanges than statutory mergers, including reor-

ganizations, notwithstanding that the "end result" is often substantially the same. The effect is an emphasis upon form rather than substance. *Bryant Heater* and *Koppers Company* are two of the decisions which the Government conceded were correctly decided (p. 6a).

Since the issue will frequently be presented because of the numerous statutory mergers that take place in the United States and since there is plain discrimination against the corporate statutory merger form, this Court should determine the constantly recurring federal questions that are presented in this case on the organization expense issues.

ARGUMENT

Net Loss Issue

As we have noted, the decision of this Court in *Central R. R.* v. *Georgia,* is significant in the decision of all of the issues presented by this petition. That case involved what was held to be a merger of one Georgia corporation into another under a special statute. It was held that an exemption from certain types of taxation given to the surviving corporation was retained by it after the consummation of the merger, although stockholders of the non-surviving constituent received stock in that survivor.

However, the exemption was held not to apply to property acquired from the non-surviving constituent, which this Court held had ceased to exist (92 U.S. at 672 and 674). The concise statement of the substance and effect of a merger which this Court there employed reads:

> "At most, it intended a merger of the Macon and Western Railroad Company into the other, a mode

> of transfer of that Company's franchise and property and a payment therefor with stock of the Central Company." (92 U.S. at 673)

The holding that the surviving corporation was entitled to a similar tax exemption in a merger is the subject of several other decisions of this Court, some cited in the above opinion. However, we have noted only decisions involving such exemptions under Georgia law because they are much more recent cases. *Wright* v. *Georgia R. & Bkg. Co.,* 246 U.S. 420 (1910), and *Redwine* v. *Georgia R. & Bkg. Co.,* 344 U.S. 925 (1953), following it, both cited above. Thus, in the absence of a constitutional statute preventing it, the single continuing corporations were held to be entitled to an exemption from taxation notwithstanding some change in the beneficial ownership thereof. A deduction is entitled to no less favorable treatment than an exemption.

Beginning on p. 39a of the Appendices, we include extracts from reports of the Ways & Means Committee of the House of Representatives and of the Senate Committee on Finance to show the legislative history of relevant portions of the 1939 and 1954 Codes.

It is quite common to say that Section 129 of the 1939 Code, the predecessor of Section 269 of the 1954 Code was adopted to prevent so-called "trafficking" in net operating loss deductions. However, the statute is not confined to those deductions and in *Maxwell Hardware,* the Ninth Circuit stated that this is a "question-begging epithet which clouds reason." It then declared that consideration of the 1954 Code must lead to the conclusion that "Congress has deliberately sanctioned such 'trafficking' in those situations where it is

not expressly abjured." (343 F. 2d 719) See also 343 F. 2d 718.

Maxwell Hardware stands for the proposition that there must be both a change in stock ownership of the *loss* corporation to the required extent, and the existence of the proscribed tax avoidance purpose—the latter alone is not sufficient. (343 F. 2d 719-21) The necessity that a tax cannot be imposed unless all conditions precedent are met is in accord with the decision in *Crooks* v. *Harrelson,* 282 U.S. 55 (1930). This case also applied the principle that tax statutes are to be strictly construed.

The Tax Court in *Maxwell Hardware,* reported *sub nom, Arthur T. Beckett,* 41 T.C. 413-4, had also required that both conditions be met. While it found that the tax avoidance purpose existed, it had held Section 269 to be inapplicable because there had not been the required shift in stock ownership. The Court of Appeals concurred though the Government sought to have Section 269 applied.

Therefore, the decision of the Tax Court was based upon the application of the doctrine of *Libson Shops,* because of the change in business. (41 T.C. 414-6) The Ninth Circuit rejected this conclusion upon a full examination of the issues and with specific reference to the differences between Section 172 of the 1954 Code and Section 122 of the 1939 Code and the inclusion of Sections 381 and 382 in the 1954 Code (343 F. 2d 715-9). So, that court concluded that Congress intended to "countenance 'trafficking' in operating loss carryovers" subject to the limitations of Sections 381 and 382. Section 269 was treated separately in the manner shown above. (343 F. 2d 718)

The adoption of Section 381 and Section 382(b) are significant, because Section 381 specifically permits the enjoyment of net operating loss deductions by the survivor in a non-taxable reorganization such as is accomplished by a statutory merger. Furthermore, under Section 382(b), the stockholders of the loss corporation need to procure only 20% of the stock of the surviving corporation in order for the surviving corporation to obtain the full benefit of the deduction (p. 36a).

It would indeed be an anomaly for the Court to hold that, for example, Consumers would be entitled to the net operating loss deduction of Follansbee if Consumers rather than Follansbee had been the surviving corporation. Yet, that result seems to be clear under Sections 381 and 382, and it would be illogical for the Court to hold that what is there specifically granted, is taken away by Section 269. See *62 Cases of Jam* v. *U.S.*, 340 U.S. at 599-600.

The Ninth Circuit emphasized the finding of the Tax Court that *Maxwell Hardware* was a taxable entity and was the entity which had suffered the losses as well as generated the income sought to be taxed. (343 F. 2d 717) In this respect, the case at bar is identical with that presented in *Maxwell Hardware*. The Ninth Circuit also rejected the view that a mere change in business required disallowance of the deduction either under Section 172 or Section 382 (343 F. 2d 717, 720). But Follansbee Union Chemical is just as much the same corporation, after the merger, as was *Maxwell Hardware* after the sale of some additional stock.

Other provisions in the 1954 Code and its legislative history are persuasive that the single corporate tax-

payer, Follansbee-Union Chemical, was entitled to the benefit of its own net operating loss carryover, since control was not shifted. Section 172(d)(4)(A) gave the benefit of net operating loss deductions to individuals in the case of a sale of operating assets (p. 31a). They had denied that under the 1939 Code on the theory that this was not a loss sustained in the conduct of a business. No amendment was deemed to be necessary to give this treatment to corporations, since the Committee Reports included this parenthetical statement:

> "(Corporations are entitled to this treatment under present law and under this section.)"

This statement and its context are copied in Item 1, p. 40a. This statement includes, in effect, a legislative construction of the 1954 Code which should be given effect. *Helvering* v. *Twin Bell Oil Syndicate,* 293 U.S. 312, 322 (1934).

Again, Section 382(b)(1) includes a provision which makes it clear that the benefits of Section 381 shall be available to either "the transferor corporation or the acquiring corporation" which has a net operating loss carryover (p. 36a). Obviously, no such deduction would be available unless Section 172 were applicable. Here, Follansbee-Union Chemical is the acquiring corporation.

There is nothing in Section 269(a) which justifies a conclusion that clause (1) proscribes the acquisition of property for stock, rather than cash, unless there be a shift in "stock control," as is required by *Maxwell Hardware.* Clause (2) presents a different question to be promptly considered.

We have noted that *Southland* did involve the acquisition of "stock control" of a profitable corporation

by a loss corporation, within the definition of "stock control." However, here, Follansbee-Union Chemical acquired the *properties* of profitable corporations, not their stock. But, in *Southland,* it was held that the acquisition of the property of the profitable corporation upon its merger into the loss corporation released the transaction from the operation of Section 269(a), because the former was "controlled" by the stockholders of the latter. Thus, the same policy of giving to a corporation the benefit of net loss carryovers unless there is a shift in "stock control" is observed.

That there is a difference between the stock of a corporation and its properties is shown by the decision in *Central R. R.* v. *Wright* involving the same exemption statute as that involved in the litigation of that railroad against the State of Georgia. In the later case, this distinction was observed in the holding that municipal corporations could tax the property of the Central Railroad but not its stock, 164 U.S. 335-6.

The reason for the failure of the Court of Appeals to give effect to the statutory definition of "stock control" is not stated in that Court's opinion, and is, we submit, inexplicable and unwarranted. Here, as in *Central R. R.* v. *Wright,* the fact that both subjects, that is the corporate stock and corporate property, are dealt with in the same statute should be significant to influence this Court not to apply clause (1) except in those cases where corporate stock, not corporate property, is acquired by a "loss" corporation.

Since the taxpayer prevailed in *Southland,* the conclusion that the proscribed purpose exists when a "loss" corporation acquires control of a profitable corporation is a mere dictum. The conclusion is based on the decision in *F. C. Publication Liquidating Corp.*

v. *Commissioner,* 304 F. 2d 779 at 781 (2 Cir., 1962), cited on pp. 15a and 16a.

We submit that the cases cited by the Second Circuit do not support the conclusion expressed. Two cases involved multiple corporation situations. All the others involved acquisitions of "stock control" of loss corporations. Furthermore, the conclusion that the "loss" corporation acquired control of the profitable corporation is in direct conflict with the finding and opinion of the Tax Court on that issue. *F. C. Publication Liquidating Corp.* v. *Commissioner,* 36 T.C. 836 at 848 and 851 (1961). In addition, the facts as to earning power and assets appear to require the conclusion that the Tax Court finding was correct, and the Court of Appeals' conclusion incorrect (36 T.C. at 837 and 847).

The conclusions of the District Court and of the Circuit Court that the proscribed purpose existed might be considered to present a non-reviewable question of fact except that each is based upon an unjustified legal conclusion as to what constitutes "evasion or avoidance of Federal income taxes." Here, the Court of Appeals relied upon the opinion in *Southland* to conclude that Section 269 "is applicable when a 'loss' corporation acquires control of a 'profitable' corporation, since the acquiring corporation thereby secures the benefit of a loss it would not have otherwise enjoyed." (358 F. 2d at 336, copied on p. 15a) The assertion of this view of that part of Section 269 which deals with the principal purpose of tax "evasion or avoidance" is truly misplaced (p. 32a).

The effect of it is to withhold a deduction expressly provided for by statute, namely, in Section 172, if the

single corporate taxpayer which suffered the loss there involved procures *income producing* property by some means. Otherwise stated, it means that a corporate taxpayer does not "enjoy" the "benefit" of a deduction to the extent that it does not have gross income to absorb *all* of the available deduction. That such a result is not contemplated by the statutory scheme is made clear by recognition of the fact that there would be no such thing as a net operating loss on such a theory, for a net operating loss is merely the "excess of the deductions allowed by this chapter over the gross income." (Section 172(c), p. 31a)

In the Court of Appeals, we urged that the permanent investment of some $8,500,000 was a more important purpose than the possible recovery of only $2,300,000. The Court of Appeals disagreed with us, but it was acting under a misapprehension as to the full contents of the entire Proxy Statement. While we urge that the existence of such a proscribed purpose is not conclusive in the absence of the required shift in stock control, we have added material at the end of the appendices to show that the Court of Appeals acted under such a substantial misapprehension. There are statements in the opinion which rather indicate that, if the relationship between the sale of Follansbee operating assets and the merger had been as the Proxy Statement demonstrates they were, the decision might have been favorable to Vulcan on the issue of the proscribed purpose. See p. 44a.

While the decision below is surely based upon a misapplication of clause (1), it appears appropriate to demonstrate that clause (2) would not operate to prevent the deduction by Follansbee-Union Chemical of its own net operating loss carryover. This results

from the fact that clause (2) most plainly deals only with deductions based on, or attributable to, the properties acquired in a non-taxable transaction and not with a deduction to which a single corporate taxpayer had always been entitled. That subject is not discussed in the opinion below.

That conclusion is indicated most definitely by the inclusion, in clause (2), of the requirement that the basis of the property acquired from a corporation "in the hands of the acquiring corporation is determined by reference to the basis in the hands of the transferor corporation. . . ." (p. 32a) The evil to which this part of the statute was directed was the acquisition of property having a high basis at a time when its value was low. As a result, the acquiring corporation could procure a deduction for depreciation or a loss on the sale of the property substantially higher than would be permissible if based on the value of the consideration paid by the acquiring corporation in the acquisition.

The concept of Section 269 was introduced into the law by Section 122 of the Internal Revenue Act of 1943, adding Section 129 to the 1939 Code. Regulations were issued thereunder in Treasury Decision 5426, issued on December 29, 1944 (1945 C.B. 196) and remained in effect until 1962. The only specific dealing in those regulations with clause 2 reads as follows:

> "(c) If the requisite *acquisition* and purpose exist, among the transactions within clause (2) of Section 129(a) is the following: A corporation acquires property having in its hands a *substituted* basis which is *materially greater than its fair market value* at the time of such acquisition in order to secure a larger excess profits credit or

> to utilize the property to create tax-reducing losses." (§ 29,129-3(c) of Reg. 111, § 39.129-3(c) of Reg. 118, emphasis supplied)

That this illustration was in accord with Congressional intention is shown by the legislative history of Section 269. Item 4 in the Appendices, p. 42a, contains extracts from the Committee Reports of both the House of Representatives and the Senate. Possibly, the most significant portion of that legislative history is the following sentence:

> "Disparities of this type generally arise where the old basis is continued in the hands of the new owner."

But no challenge is made to any deduction with respect to the property acquired from Consumers and Frontier in reliance upon Section 269. So clause (2) is plainly inapplicable.

Organization Expense Issue

The case which originally introduced the concept that organization expenses should not be allowed as a deduction in the case of a merger, although allowable in the case of dissolution, is *Citizens Trust Company,* 20 BTA at 393. All subsequent statements of that import are based, in the final analysis, on that decision, and the Court of Appeals copied an extract from the opinion therein as follows:

> "It has been said that 'all "rights, powers, liabilities and assets" [survive] except the "indicia and attributes of a corporate body distinct from that into which it is merged."'" (p. 8a-9)

The foregoing statement is based upon an extract from *McKinney's Consolidated Laws of New York,*

Vol. 4, p. 402, which is copied in the opinion in *Citizens Trust*. The words which are copied in that opinion come from the opinion in *Bank of Long Island v. Young*, 101 Appel. Div. 44, 91 N.Y.S. 1047 (1905). But this case involved a totally different issue, namely whether the surviving bank would remain on an obligation of guaranty owing to the merged bank.

That the conclusion expressed in *Citizens Trust* does not represent the law of New York is indicated by the decision of the highest court of that state in the case of *In Re Bergdorf's Will*, 206 N.Y. 308, 99 N.E. 715 (1912) ("*Bergdorf's case*"). It was therein held that the merged trust company did not exist within or as a part of the surviving trust company and that except as its corporate existence was continued to permit suits against it, it was non-existent. In support of this conclusion, the New York Court of Appeals cited numerous cases, including *Central R. R.* [illegible] and two other decisions of this Court. Again the New York Court of Appeals said that for all of the purposes of the consideration there involved, the merged corporation ceased to exist when the merger was accomplished (206 N.Y. 315-6, 99 N.E. 717).

The New York statute provided that the surviving corporation should hold and enjoy "all rights of property, franchises and interests, etc." in the same manner as the merged trust company. But in *Bergdorf's case*, the New York court stated that this meant that every right of the merged company ("except the right to be a corporation") was to pass to the surviving trust company (206 N.Y. 315, 99 N.E. 717).

Since *Citizens Trust Company*, and decisions following it, including that of the Court of Appeals in the

case at bar, are based upon an erroneous view of the law of New York and enunciate a theory which is in conflict with the decisions of this Court respecting corporate mergers, it should be specifically rejected as an authority in dealing with the deductibility of organization and reorganization expenses upon the consummation of such a merger.

Furthermore, the discrimination against reorganizations and other non-taxable transactions in different forms should be eliminated. By quotation from the opinion in *Central R. R.* v. *Georgia,* 92 U.S. at 673, we have called attention to the fact that a merger involves a transfer of the property of the merged corporation in consideration of the issue of stock of the survivor to the stockholders of the former. Transfers of the property of one corporation for stock in another pose a constitutional problem under *Dartmouth College* v. *Woodward,* 4 Wheaton 518.

This, no doubt, is the reason for the inclusion of dissent provisions in merger statutes, e.g., *Central R. R.* v. *Georgia,* 92 U.S. at 671-2, *Mason* v. *Pewabic Mining Co.,* 133 U.S. 50 (1890), but it was a type of transaction commonly used before the adoption of statutes authorizing the sale of all of the property of a corporation, even for cash. Thus, a statutory merger accomplishes the same "end result" as does a reorganization in pursuance of paragraph (C) of Section 368(a)(1) of the 1954 Code when the stock of the transferee is promptly distributed. The transferee may assume the liabilities of the transferor without impairing the non-taxability of the reorganization.

Therefore, the income tax consequences should be the same with respect to the deductibility of organiza-

tion and reorganization expenses. See *American Processing & Sales Company,* where cited just before the argument, 164 F. 2d at 920.

CONCLUSION

The decision of the Court of Appeals deals erroneously with at least two matters of importance in the federal income tax field which may be expected to recur constantly. We respectfully request that the writ of certiorari be issued.

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APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1970

No. 30116 & 30117

D.C. Docket No. CA 65-61 & CA 65-333

VULCAN MATERIAL COMPANY, *Plaintiff-Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant-Appellee.*

Appeals from the United States District Court for the Northern District of Alabama

Before BELL, AINSWORTH and ALDISERT,* Circuit Judges.

Judgment

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Alabama, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that plaintiff-appellant pay to defendant-appellee, the costs on appeal to be taxed by the Clerk of this Court.

May 28, 1971

Issued As Mandate: July 6, 1971.

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* Of the Third Circuit, sitting by designation.

[Filed June 25, 1971]

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1970

No. 30116 & 30117

VULCAN MATERIALS COMPANY, *Plaintiff-Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant-Appellee.*

Appeals from the United States District Court for the Northern District of Alabama

(June 25, 1971)

Before BELL, AINSWORTH and ALDISERT,* Circuit Judges.

On Petition for Rehearing

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

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* Of the Third Circuit, sitting by designation.

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Nos. 30116 & 30117

VULCAN MATERIALS COMPANY, *Plaintiff-Appellant,*

v.

UNITED STATES OF AMERICA, *Defendant-Appellee.*

Appeals from the United States District Court for the Northern District of Alabama

(May 28, 1971)

Before BELL, AINSWORTH and ALDISERT,*
Circuit Judges.

ALDISERT, Circuit Judge: Two principal issues are presented by these appeals from the district court's denial of federal income tax refunds: (I) whether organization or reorganization expenses incurred by appellant's predecessors, and concededly capital in nature and not deductible when incurred, became deductible upon the occurrence of statutory mergers carried out pursuant to 26 U.S.C. § 368 (a)(1)(A); (II) whether appellant met its burden of overcoming the Commissioner's determination that one of its predecessors, Follansbee Steel Corporation, had acquired two other corporations for the principal purpose of tax avoidance. If appellant did not satisfy this burden, it is conceded that net operating loss carryovers were properly disallowed under 26 U.S.C. § 269(a)(2).

A stipulation of facts with accompanying documentary exhibits constituted the sole evidence at trial. No oral testimony was offered. The salient facts are summarized in the opinion of the district court, 308 F. Supp. 53, 54-55 (N.D. Ala. 1969):

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* Of the Third Circuit, sitting by designation.

On December 23, 1954, Consumers Company (Consumers) and Frontier Chemical Company (Frontier), both Delaware corporations, were merged into a third Delaware corporation theretofore named Follansbee Steel Corporation (Follansbee). Prior to the aforementioned merger, Follansbee disposed of all of its operating assets. Upon merger, the corporation owned approximately nine million dollars in liquid assets and had an approximate six million dollar net operating loss. In the merger proceedings, the name of the surviving corporation was changed from Follansbee Steel Corporation to Union Chemical and Material Corporation (Union Chemical). On December 31, 1957, Union Chemical was merged into the plaintiff. Each of the aforementioned mergers constituted reorganizations within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code of 1954. . . .

In 1934, the predecessor of Consumers filed a petition in the United States District Court for the Northern District of Illinois for a reorganization under Section 77B of the Bankruptcy Act. During the period 1933 through 1937, various expenditures were incurred with respect to the reorganization and to the organization of the former corporation into Consumers. Likewise, Follansbee's predecessor filed a petition in bankruptcy in 1934 and in 1940 was reorganized into Follansbee Steel Corporation. In 1946, a further corporation merged with Follansbee and as a result of the reorganization and merger, expenses were alleged to have been incurred. Each of the aforementioned expenditures is conceded to be capital in nature and thus not deductible when paid or incurred.

On its 1957 corporate income tax return, Union Chemical deducted all of the aforementioned expenses. A subsequent audit resulted in the disallowance of these deductions, followed by a deficiency assessment

totaling $369,453.93 which was paid. A claim for refund of this amount was filed and thereafter rejected on the theory that the aforementioned expenditures were capital in nature and not deductible upon merger.

The Internal Revenue Service further refused to make a refund based on a depletion allowance on the ground that plaintiff had improperly carried over Follansbee's premerger net operating losses in contravention of Sec. 269 of the 1954 Code. Although the deficiency which resulted from the carry-forward was not assessable due to the bar of the statute of limitations, it was nevertheless of sufficient size to offset any recovery to which the plaintiff might otherwise have been entitled. On March 24, 1965, plaintiff's claim for refund was formally rejected.

. . .

Prior to December 23, 1954, the date on which Consumers and Frontier merged into Follansbee, the latter corporation disposed of all of its machinery, tools, inventory, etc., which it used in its steel operation; hence, the corporation was but a mere shell. However, on the date of merger its sole possessions consisted of approximately nine million dollars in liquid assets and approximately a six million dollar net operating loss which it could not utilize due to the abatement of its operations. The companies which merged into Follansbee were engaged in the stone and chemical business. Following the merger, the new entity continued to operate profitably. In each of the years 1955, 1956 and 1957, portions of the pre-merger net operating loss suffered by Follansbee were used to offset the profits of the Consumers and Frontier enterprises.

I.

Reorganization Expenses

It is well established that recapitalization or reorganization expenditures of a corporation are not ordinary and necessary business expenses but rather capital expenditures which are not deductible when incurred. *General Bancshares Corp.* v. *Commissioner,* 326 F.2d 712 (8 Cir.), *cert. denied,* 379 U.S. 832 (1964); *Bush Terminal Bldgs. Co.* v. *Commissioner,* 204 F.2d 575 (2 Cir. 1953); *Missouri-Kansas Pipe Line Co.* v. *Commissioner,* 148 F.2d 460 (3 Cir. 1945). In *Godfrey* v. *Commissioner,* 355 F.2d 82, 85 (6 Cir. 1964), the court stated:

> An expenditure is of a capital nature "where it results in the taxpayer's acquisition or retention of a capital asset, or in the improvement or development of a capital asset in such a way that the benefit of the expenditure is enjoyed over a comparatively lengthy period of business operation." Louisiana Land & Exploration Co. 1. Commissioner, 7 T.C. 507, aff'd. 161 F.2d 842, C.A. 5 [(1947)]. . . .

While appellant concedes that the capital expenditures were not deductible when paid or incurred, the government acknowledges that capital expenditures of the nature here involved may be deducted upon the dissolution and liquidation of a corporation. *Bryant Heater Co.* v. *Commissioner,* 231 F.2d 938 (6 Cir. 1956); *Commissioner* v. *Wayne Coal Mining Co.,* 209 F.2d 152 (3 Cir. 1954); *Shellabarger Grain Products Co.* v. *Commissioner,* 146 F.2d 177 (7 Cir. 1944; *Koppers Co.* v. *United States,* 278 F.2d 946 (Ct. Cl. 1960); *Pacific Coast Biscuit Co.* v. *Commissioner,* 32 B.T.A. 39 (1935); *Malta Temple Assn.* v. *Commissioner,* 16 B.T.A. 409 (1929).

The issue here is whether the organization or reorganization expenses of appellant's predecessors may now be claimed as deductions, as urged by appellant, or whether the distinctions between dissolution and merger will preclude such deductions in a merger situation.

A statutory merger[1] effects a combination of two or more corporations in accordance with the detailed procedures established by the corporation laws of a state, with one of the corporations continuing as the same legal entity it was before the transaction. Stated differently, a merger is

> the absorption of one corporation by another, which retains its name and corporate entity with the added capital, franchises and powers of the merged corporation. It is the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged therein.

15 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 7041. See *Argenbright* v. *Phoenix Finance Co.*, 21 Del. Ch. 288, 187 A. 124 (1936); *Fidanque* v. *American Maracaibo Co.*, 92 A.2d 311 (Del. Ch. 1952)). Thus, the distinguishing characteristics of a merger are (1) an assumption by the surviving corporation "of all the rights and liabilities of the disappearing entitles," 8 CAVITCH, BUSINESS ORGANIZATIONS § 167.07[2], and (2) the cessation of the "separate existence of all the constituent corporations . . . except the one into which the other or others of such constituent corporations have been merged." 8 Del. Code Anno. § 259(a).

A corporate dissolution, on the other hand, represents the termination of the corporation's existence as a legal person. Once corporate existence ends, so do the privileges, powers, rights and duties which arose from corporate existence, except for specific purposes recognized by operation of law. 8 CAVITCH, *supra*, § 185.02.

> The term "dissolution" as applied to a corporation, signifies the extinguishment of its franchise to be a

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[1] See 8 Del. Code Anno. § 251 *et seq.* and 14 N.J. Stat. Anno. 14:21-1 *et seq.* for the statutory provisions of the states in which the corporations were organized.

> corporation and the termination of its corporate existence. It has been described as that condition of law and fact which ends the capacity of the body corporate to act as such and necessitates a liquidation and extinguishment of all legal relations existing in respect of the corporate enterprise. It denotes the complete destruction of the corporation, and, within contemplation of law, is equivalent to its death, being sometimes likened to the death of a natural person.

16A FLETCHER, *supra*, § 7866.[2]

Thus, although in both a statutory merger and a dissolution the merged or dissolved corporate entity ceases to exist, fundamental distinctions inhere in the two processes. In a dissolution, the privileges, powers, rights and duties of the corporation come to an end and suffer a corporate death.[3] In a merger, these attributes of corporate life are transferred to the surviving corporation and are there continued and preserved. It has been said that "all 'rights, powers, liabilities and assets' [survive] except the 'indicia and attributes of a corporate body distinct from that

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[2] Dissolution and liquidation refer to entirely separate concepts: a liquidation has no direct effect upon the existence or non-existence of the corporate entity; it concerns the settling of the corporate affairs, *i.e.*, gathering assets, accounting with creditors and debtors, and apportioning the profit or loss to its stockholders. Farmers' State Bank & Trust Co. v. Brady, 137 Tex. 39, 152 S.W.2d 729 (1941); *In re Burger's Estate,* 276 Mich. 485, 267 N.W. 887 (1936); Browne v. Hammett, 133 So.C. 446, 131 S.E. 612 (1926); Gibson v. American Ry. Express Co., 195 Iowa 1126, 193 N.W. 274 (1923).

[3] "From the time of that entry [order of dissolution] the corporation has been dead, all its agencies ended, its employees, including attorneys, discharged: and is put, without exception or notice of appeal, beyond all future corporate activity." *State ex rel. Attorney General* v. *Fidelity Loan & Trust Co.*, 113 Iowa 439, 440, 85 N.W. 638-39 (1901).

into which it is merged.' " *Citizens Trust Co.* v. *Commissioner,* 20 B.T.A. 392, 393 (1930).

Recognizing these distinctions, we accept the government's contention that the provision for deduction of capital expenditures upon dissolution of a corporation is not applicable when the corporation becomes a constituent of a surviving corporation in a merger. The organization and reorganization expenses of the constituent corporations in the case at bar were clearly capital in nature. These assets were not lost but were continued beyond the corporate existence of the constituent corporations and persisted as capital assets of the surviving corporation. So construed, the expenses were not deductible.[4]

II.

Operating Loss Carryover

Appeal No. 30,177[5] requires us to decide whether the net operating loss incurred by Follansbee Steel Corporation in its taxable year 1954, which was not absorbed by its

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[4] Another point was raised for our consideration in the appeal at 30,116: whether payment by Consumers Company, a predecessor corporation, to the state of Illinois, allegedly for the privilege of doing business, qualifies as a deduction. Upon proof that payment was made to the State of Illinois for that purpose and that such right was duplicative or no longer necessary, it could be a proper subject for consideration. We are not persuaded, however, that appellant met the appropriate burden of proof. The stipulation, 8 (p) merely states:

> Secretary of State of Illinois—$3,209.24. The amount listed was paid to the Secretary of State of Illinois for various services including fees for ministerial and recording services required under applicable state laws of Illinois.

[5] The parties stipulated that if it is concluded that the net operating losses are not allowable as deductions under section 172 by reason of section 269, the taxpayer will not be entitled to any recovery in Appeal No. 30,117 because taxpayer's indebtedness to the United States exceeds the amount claimed in these actions.

taxable income or that of its successor Union Chemical and Material Corporation in taxable years prior and subsequent thereto, was allowable to Union Chemical as a deduction for its taxable year 1957 pursuant to 26 U.S.C. § 172. The Commissioner disallowed the deduction by reason of section 269(a)(2),[6] finding that the principal purpose of the merger of Follansbee (the loss corporation) and Consumer and Frontier (profit corporations), was to utilize the net operating loss of Follansbee to offset future income of the surviving corporation.

Follansbee discontinued its steel operations and sold its assets prior to the merger in 1954. Thus, by the time of the merger it had become a non-operating corporation with liquid assets of $9,000,000.00, and a net operating loss of $6,000,000.00 resulting from the sale of assets. Follans-

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[6] Internal Revenue Code of 1954, 26 U.S.C.:

§ 269. *Acquisitions made to evade or avoid income tax.*
(a) In general.—If—

(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then [such deduction, credit, or other allowance be disallowed]. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

bee successfully claimed the carryback against income earned and reported in taxable years prior to 1954 as a deduction under Section 172. What the Commissioner challenged was the attempt by Union Chemical, the successor corporation after the merger, to take advantage of the loss carryback of Follansbee.

Immediately prior to the merger, Frontier was actively operating in the field of chemicals, and Consumer in building materials, coal and ice. Following the merger, stockholders of the loss corporation, Follansbee, obtained 57% controlling interest in the surviving corporation, which continued the former operations of Frontier and Consumer with its corporate name changed to Union Chemical.

Although the acquisition of a controlling stock interest in a corporation may serve multiple purposes, if the primary or single most important purpose of the acquisition is tax avoidance or evasion, tax benefits are barred.[7]

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[7] Section 269 was "designed to put an end promptly to any market for, or dealings in, interests in corporations or property which have as their objective the reduction through artifice of the income or excess profits tax liability." H. Rep. No. 871, 78th Cong., 1st Sess., 49 (1944 Cum. Bull. 901, 938). The Senate Report to the Revenue Act of 1943 makes it clear that the proscribed purpose exists "if the evasion or avoidance purpose outranks or exceeds in importance, any other *one* purpose." H. Rep. No. 627, 78th Cong., 1st Sess., 59 (1944 Cum. Bull. 973, 1017).

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) provide:

> § 1.269-3 *Instances in which section 269(a) disallows a deduction, credit, or other allowance.*
>
> (a) *Instances of disallowance.* Section 269 specifies two instances in which a deduction, credit or other allowance is to be disallowed. These instances [are] described in paragraphs (1) and (2) of section 269(a). . . .
>
> . . .

In either instance the principal purpose for which the acquisition was made must have been the evasion or avoidance of Federal in-

In *Southland Corp.* v. *Campbell,* 358 F.2d 333, 336 (5 Cir. 1966), this court emphasized that section 269 "is applicable only in certain carefully circumscribed situations—it may be invoked only where there has been an acquisition of *control,* the *principal purpose* of which is evasion or avoidance of taxes." (Emphasis by the court).[8] The statute defines "control" as the ownership of stock possessing at least 50 percent of the total combined voting power of all

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come tax by securing the benefit of a deduction, credit, or other allowance which such person or persons, or corporation, would not otherwise enjoy. If this requirement is satisfied, it is immaterial by what method or by what conjunction of events the benefit was sought. Thus, an acquiring person or corporation can secure the benefit of a deduction, credit, or other allowance within the meaning of section 269 even though it is the acquired corporation that is entitled to such deduction, credit, or other allowance in the determination of its tax. If the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, it is the principal purpose. This does not mean that only those acquisitions fall within the provisions of section 269 which would not have been made if the evasion or avoidance purpose was not present. The determination of the purpose for which an acquisition was made requires a scrutiny of the entire circumstances in which the transaction or course of conduct occurred, in connection with the tax result claimed to arise therefrom. For the presumption of a principal purpose of tax evasion or avoidance, see section 269(c) and § 1.269-5.

[8] In *Southland* the loss corporation was Carribean, a shipping business in which Murchison Brothers had a 50 percent ownership. The profitable corporation was Old Cabell's, engaged in the dining and grocery business. Murchison stockholders, the majority stockholders in Old Cabell's, gave to Caribbean their stockholdings in Old Cabell's, and later donated back to Caribbean substantial shares of Caribbean stock. Subsequently the two corporations merged, with Caribbean being the surviving corporation. The court held that the acquisition portion of 269(a) was not met because "immediately before Caribbean acquired control of it, Old Cabell's was controlled by the stockholders of Caribbean, and, therefore, under the express terms of the statute it is not applicable." 358 F.2d at 337.

classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock. *See* 2 RABKIN & JOHNSON FEDERAL INCOME, GIFT & ESTATE TAXATION, § 11.05.

Thus, we are concerned with two lines of inquiry: (a) whether there has been an acquisition of control[9] as contemplated by section 269, and, if so, (b) whether the principal purpose of the merger was to evade or avoid taxes.

It is important to recognize what is not before us. We do not have a single corporation, which, with no change in stock ownership, discontinued a losing business and entered a totally different venture which proved to be profitable; nor do we have a single corporation which experienced

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[9] The government urges that this case may turn on the test set forth in Revenue Ruling 63-40: Where there is no change in stock ownership either before the discontinuance of its former business activity or after the commencement of its new business activity, the net operating loss deduction is allowable. But where there is "more than a minor change in stock ownership of a loss corporation which acquires a new business enterprise, the Service may continue to contest the deductibility of the carry-over of the corporation's prior losses against income of the new business enterprise." We consider this a simplistic approach. The question is not the *amount* of stock ownership change, but the *effect* of the change upon control.

Addressing itself to the question of control, Technical Information Release No. 773 of the IRS dated October 13, 1965, declared: "where there has been both a 50 per cent or more shift in the benefits of a loss carryover (whether direct or indirect and including transactions having the effect of shifting the benefits of the loss by shifting assets, stock, profit interests or other valuable rights) and a change in business as defined in section 382(a) and the regulations thereunder," the doctrine of *Libson Shops Inc.* v. *Koehler*, 353 U.S. 382 (1957) will be applied: "a surviving corporation in a merger may not carry over and deduct pre-merger net operating losses of one business against post-merger income of another which was operative and taxed separately before the merger." Rev. Ruling 58-603, TIR-89, August 25, 1958.

a substantial change in ownership in the same taxable year in which the "corporation [had] not continued a trade or business substantially the same as that conducted before the change in the percentage ownership" of the stock. 26 U.S.C. § 382(a); nor did the situation here involve a statutory merger of several corporations, each of which conducted substantially the same business prior to the merger, with no basic post-merger change of stock ownership, as in *Libson Shops Inc.* v. *Koehler,* 353 U.S. 382 (1957); nor did a corporation which, after reorganization in which there had not been a 50 percent change in the beneficial ownership of the loss, engage in substantially the same business, as in *United States* v. *Jackson Automobile, Inc.,* (sic) 371 F.2d 808 (5 Cir. 1967); nor was there a merger of two corporations, each of which was controlled by the same stockholders prior to the merger as in *Southland Corp.* v. *Campbell, supra;* nor was this a statutory merger in which the surviving corporation conducted a business substantially different from that previously operated by the loss corporation but with only a minor change in the beneficial ownership of the loss, Rev. Rul. 63-40.

What we do have is: (1) a substantial change in the beneficial ownership of the loss, but not one which exceeds 50 percent, for the original stockholders of Follansbee, who owned 100 percent of the loss corporation stock, became owners of 57 percent of the surviving corporation of the merger; (2) a substantial change in the beneficial ownership of a profitable corporation—these same stockholders who had no ownership before the merger became owners of 57 percent thereafter; (3) a subsequent operation of a business substantially different from that previously conducted by the loss corporation.

Because the Follansbee stockholders who owned 100 percent of the pre-merger loss corporation ultimately owned over 50 percent of the acquiring corporation, and because there was no surrender of 50 percent of the beneficial

ownership of the loss, it is suggested that a provision of the Commissioner's Technical Information Release No. 773, *supra,* note 9, if literally applied, would authorize the deduction:

> The Service will not rely on *Libson Shops* under the 1954 Code in any loss carryover case where there has been less than a 50 percent change in the beneficial ownership of the loss or where there has been no change in business as defined in section 382(a) and the regulations thereunder. However, the Service will continue to rely on sections 269 and 482, where appropriate, in dealing with the carryover of losses. Revenue Ruling 63-40, C. B. 1963-1, 46 will be modified to the extent inconsistent herewith.

We do not quarrel with this statement as far as it goes. But the mischief in relying solely upon IRS technical releases and revenue rulings is that, for the most part, they speak to the limited fact situations before the Service at that moment. They do not purport to be comprehensive statements of substantive law. From this terse technical information release we cannot conclude that it is only a change in the beneficial ownership of the *loss* which will determine the allowance *vel non* of a net operating loss carryover.

Indeed, this court has deemed it settled that section 269 "is applicable when a 'loss' corporation acquires control of a 'profitable' corporation since the acquiring corporation thereby secures the *benefit* of a loss it would not have otherwise enjoyed. *F. C. Publication Liquidating Corp.* v. *Commissioner,* 304 F.2d 779, 781 (2 Cir. 1962)." *Southland Corp.* v. *Campbell, supra,* 358 F.2d at 336. In *F. C. Publication Liquidating Corp., supra,* the court denied a loss carryover. The loss corporation acquired a profitable corporation, giving the shareholder majority interest in the surviving corporation. There, as here, the business of the loss corporation was not continued; the surviving cor-

poration carried on the business previously conducted by the profitable corporation. Thus, these cases adhere to the principle enunciated in *Urban Redevelopment Corp.* v. *Commissioner*, 294 F.2d 328, 332 (4 Cir. 1961):

> It is now well established that the deduction should be disallowed when . . . it is claimed by either the acquired corporation or by the person who acquired control of the corporation and who will get the benefit of the deduction, albeit, indirectly.

In this case there was a shift of 57 percent of the ownership of a profitable corporation. Therefore, considering solely the question of "control," we are persuaded that there was an acquisition of the control, under section 269, of profitable corporations which gave the acquiring corporation "the benefit of a loss it would not have otherwise enjoyed." *F. C. Publication Liquidating Corp.* v. *Commissioner, supra.*

Paramount in our approach to the troublesome question of the merger's primary purpose is a recognition that the 26 U.S.C. § 269 does not foreclose the right of an acquiring corporation to take advantage of a past operating loss. Congress did not close the door to a proper and legitimate use of the net operating loss deduction by a successor corporation to a statutory merger. Moreover, even the change in control of either the beneficial ownership of the loss or profitable constituent corporations will not preclude the proper utilization of the operating loss carryover deduction. Congress sought to deny tax benefits only to those corporate acquisitions in which "the primary purpose . . . is evasion or avoidance of Federal income taxes."

Thus, if Follansbee's acquisition of the chemical and building materials companies was motivated by legitimate business reasons, that tax considerations played a role, even an important role, would not defeat the right to tax benefits so long as the tax considerations did not constitute

the "principal purpose" of the merger. Only "if the purpose to evade or avoid Federal income tax exceeds in importance any other purpose, [is it] the principal purpose." Treasury Reg. 41.269-3(a)(2).

There are several significant factors present in the events which gave rise to this appeal. The net operating loss itself is not questioned. It resulted from a sale of Follansbee assets in 1954, which took place prior to the December 23, 1954 merger. As noted, the Commissioner did not question the right of *Follansbee* to use this loss to offset earned income in years prior to 1954. It was only when *Union Chemical,* the successor corporation to the three-company merger, attempted to stand in the shoes of Follansbee, after the merger, and apply this loss to offset post-merger earned income that the Commissioner denied the deduction and made the determination of tax liability.

The taxpayer made the payment under protest, and sued for a refund. In such a proceeding, which is in the nature of a common law action for money had and received, the burden is on the taxpayer to prove that the Commissioner's determination of the tax was erroneous. *Lewis* v. *Reynolds,* 284 U.S. 281, 283 (1932). Moreover, in *Bobsee Corp.* v. *United States,* 411 F.2d 231, 238 (5 Cir. 1969) (footnote omitted), this court said:

> The burden of proving that tax avoidance was not the principal purpose is on the taxpayer. Theoretically the question of purpose is purely subjective; pragmatically, however, the trier of fact can only determine purpose from objective facts. Thus, unless the taxpayer can muster facts sufficiently plausible to convince the trier of the purity of his motives, the IRS will prevail.

As indicated above, there was no oral testimony adduced at trial. Pertinent facts to this issue were presented in paragraphs 31-34 of the written stipulation No explicit

statement for the purpose of the merger may be gleaned from paragraphs 31 and 32. Paragraph 33 delineated what financial equities were brought to and received by the merged group, and this was expressed only in statements of fair market value and book value. In addition, a reference was made to Follansbee's proxy statement and to a listing of shares. Paragraph 34 described the net operating loss carryover.

There is nothing explicit in the stipulation which describes the purpose of the merger. Therefore, we must look for illumination to Exhibit "C" which is "K. Summary" of the Proxy Statement issued by Follansbee to its shareholders prior to the meeting which approved the proposed merger. From the meager information therein presented, it becomes apparent that Follansbee had converted its assets to cash at some point before the stockholders' meeting.[10] We are not old, nor does the record disclose, the precise date of the sale of assets, or whether the sale was a Follansbee decision separate and apart from the proposed merger with Frontier and Consumer and independent of a proposed merger with any other companies. We are not told whether there was any contemplation of liquidation at the time of the sale of assets.

The proxy statement does disclose, however, the reason for the sale of assets—Follansbee's "relatively insecure position in the steel industry."[11] From the standpoint

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[10] Paragraph 33 indicates that as of September 9, 1954, Follansbee has already a liquid position showing cash of $9,286,620. Obviously the sale of assets took place before this date.

[11] "In considering the reason for the sale of Follansbee assets. Follansbee's relatively insecure position in the steel industry was discussed. Mention was also made of the present outlook of the industry generally. The most widely accepted index to conditions in the steel industry is the rate of operations as compared to capacity. Each month since January, 1953, the industry-wide rate of operations, has shown, except for minor and relatively insignificant recoveries, a steady decline. . . ."

of the taxpayer's burden at trial, some proof of an association between the sale of assets with the precise merger would have been helpful. Even more persuasive would have been some evidence, if available, that the reason for the *merger* was Follansbee's lack of confidence in the future of the steel industry and a corresponding confidence in the future of the business of the acquired corporations.[12] Absent proof of a relationship between the sale of the assets and the ultimate merger, it becomes difficult to conclude that the stated business purpose of the sale of assets was also the business purpose of the merger.

Conspicuously absent from the trial record was a statement by any Follansbee official, or corporate minutes, serving to contradict the Commissioner's conclusion that the primary purpose of the merger was tax evasion or avoidance or stating affirmatively the actual purpose for the merger. At best, the purpose had to be divined by the court from an examination of a portion of a proxy statement which, *inter alia,* contained the statement:

> As previously stated, the sale and merger will create a carry-forward tax loss estimated by tax counsel at approximately $4,500,000. This means that the first $4,500.00 of profits earned by the Continuing Corporation through the anticipated successful operation of Consumers' and Frontier will not be subject to Federal Income Tax.[13]

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[12] The proxy statement included an analysis of Frontier's chemical operation and a sketchy description of Consumer's business.

[13] The proxy statement also stated:

> The Continuing Corporation, by virtue of the sale of Follansbee assets, will be in a position to supply substantial amounts of additional needed capital to both Frontier and Consumers.

Accordingly, in exercising our review responsibilities [14] we have carefully examined the entire record to resolve the issue upon which this appeal will turn: Did the taxpayer meet its burden of proving that the Commissioner's determination was in error? We are persuaded that the taxpayer did not meet its burden. It offered no substantial evidence of business purpose and chose to rest its case on the skeletal, tightly worded factual stipulation and on a proxy statement. We do not intimate an absolute necessity for testimony denying that tax avoidance was the primary purpose of the merger, although such testimony, augmented with affirmative statements or proof of appropriate business purpose, would have formidably strengthened this taxpayer's case. At the very minimum, however, for the taxpayer to have prevailed, some substantial evidence should have been introduced by way of explanation of the business purpose for the merger.

AFFIRMED.

[14] We reject the government's invitation to decide this appeal on the clearly erroneous doctrine. *Bay Sound Transp. Co.* v. *United States*, 410 F.2d 505 (5 Cir. 1969). Since there was no oral testimony and no necessity to decide the credibility of witnesses, the fact finder enjoyed no advantages not possessed by us as a court of review.

Relevant Provisions of the General Corporation Law of New Jersey Contained in What Is Designated as "Title 14 Corporations General," the Various Sections of Which Are Designated as "§ 14:1-1," Etc.

14:12-1. CORPORATIONS WHICH MAY MERGE OR CONSOLIDATE.—Any two or more corporations organized under any law or laws of this state, or any corporation organized under the laws of any other state for the purpose of carrying on any kind of business of the same or a similar nature, may merge or consolidate into a single corporation, which may be either one of such merging or consolidating corporations, or a new corporation under the laws of this state to be formed by means of such merger and consolidation; provided, that a merger or consolidation of a corporation of another state, so proposed to be merged or consolidated with such New Jersey corporation, is authorized by the laws of such other state.

The provisions of this chapter relative to merger and consolidation shall not apply to any railroad, turnpike, insurance, canal or banking companies, savings banks, or other corporations intended to derive profit from the loan or use of money.

14:12-2. PROCEDURE; JOINT AGREEMENT.—The directors of the several corporations proposing to merge or consolidate shall enter into a joint agreement under the corporate seals of the respective corporations for their merger or consolidation, prescribing:

a. The terms and conditions of the merger or consolidation and the mode of carrying it into effect;

b. The name of the new corporation, if one shall be so formed or created, or of the consolidated corporation, as the case may be;

c. The number, names and post-office addresses of the first directors and officers of the new or consolidated corporation, who shall hold office until their successors

are chosen or appointed, either according to law or the by-laws of the new corporation, and in case of the creation of a new corporation, how and when the directors and officers shall be chosen or appointed;

d. The number of shares of the capital stock of the new or consolidated corporation, whether common or preferred, and, if any such stock has nominal or par value, the amount or the par value of such shares;

e. The manner of converting the capital stock of each of such merging or consolidating corporations into the stock or obligations of the new or consolidated corporation; and

f. Such other provisions and details as the first mentioned directors shall deem necessary to perfect the merger or consolidation.

14:12-3. AGREEMENT; SUBMISSION TO STOCKHOLDERS; FILING; CERTIFIED COPY TO BE EVIDENCE.—The agreement shall be submitted to the stockholders of each of the merging or consolidating corporations at separate meetings thereof, called for the purpose of considering the same, upon twenty days' notice of the time, place and object thereof, mailed to the last known post-office address of each of such stockholders. At each of such stockholders' meetings a vote of the stockholders shall be taken by ballot, cast in person or by proxy, for the adoption or rejection of such agreement, each share of stock entitling the holder to one vote.

14:12-5. RIGHTS AND POWERS; DUTIES AND LIABILITIES.—When such merger or consolidation is effected, all the rights, privileges, powers and franchises of each of such corporations, both of a public and private nature, all real and personal property, all debts due on any account, as well for stock subscriptions as all other things in action or belonging to each of the corporations, and all and every other interest, shall vest in the consolidated corporation as effec-

tually as they were vested under the laws of this state in any of such corporations by deed or otherwise, shall not revert or be in any way impaired by reason of this chapter.

All rights of creditors and all liens upon the property of the former corporations shall be preserved unimpaired, and the respective former corporations may be deemed to continue in existence in order to preserve the same, and all debts, liabilities, restrictions and duties of the former corporations shall thenceforth attach to such consolidated corporation, and may be enforced against it to the same extent as if they had been incurred or contracted by it.

14:13-4. Corporate Entity Continued for Purpose of Winding Up.—All corporations, whether they expire by their own limitation or be annulled by the legislature or be otherwise dissolved, shall be continued bodies corporate for the purposes of prosecuting and defending suits by or against them, of enabling them to settle and close their affairs, of disposing of and conveying their property and of dividing their capital, but not for the purpose of continuing the business for which they were established.

14:13-1. Dissolution; Procedure.—Every corporation organized under this title may be dissolved in the following manner:

The board of directors shall pass a resolution, declaring it advisable and most for the benefit of the corporation that it be dissolved and calling a meeting of the stockholders to take action thereon. The meeting shall be held upon such notice as the by-laws provide, and in the absence of such provision, upon ten days' notice given personally or by mail. If two-thirds in interest of all the stockholders, whether with or without voting powers and without regard to class, shall at such meeting or any adjournment thereof vote in favor of the dissolution of the corporation and consent thereto in writing, a certificate of such dissolution shall be made by the corporation under its seal and the hands of the president or vice president and the secretary

or assistant secretary. The certificate shall be acknowledged or proved as in the case of deeds of real estate, and, together with such consents in writing and a list of the names and post-office addresses of the directors or officers certified as aforesaid, shall be filed in the office of the secretary of state, who shall thereupon issue a certificate that such certificates and consents have been filed. Upon the issuance of such dissolution certificate by the secretary of state the corporation shall thereupon be dissolved, except as hereinafter provided, and the board of directors shall proceed to settle up and adjust its business and affairs, except that the consent in writing of the stockholders may fix a date subsequent to the date of the issuance of such certificate by the secretary of state as the date on which the dissolution shall take effect, which shall be stated in the certificate issued by the secretary of state. Whenever all the stockholders shall consent in writing to a dissolution, no meeting or notice thereof shall be necessary, but on filing such consents in the office of the secretary of state he shall forthwith issue a dissolution certificate. The board of directors shall in every case cause such certificate of the secretary of state to be published for three weeks successively, at least once in each weekly in a newspaper published in the county in which the principal office of the corporation was last located, and shall, after the completion of such publication, file proof thereof in the office of the secretary of state.

Extracts From "General Corporation Law of the State of Delaware" (Which Now Constitute a Part of Title 8 of the Delaware Code 1953).

Sec. 251 Consolidation or merger of domestic corporations

"(a) Any two or more corporations organized under the provisions of this chapter, or existing under the laws of this State, for the purpose of carrying on any kind of business, may consolidate or merge into a single corporation which may be any one of said constituent corporations or a new

corporation to be formed by means of such consolidation or merger as shall be specified in the agreement required by subsection (b) of this section."

"(b) The directors, or a majority of them, of such corporations as desire to consolidate or merge, may enter into an agreement signed by them and under the corporate seals of the respective corporations, prescribing the terms and conditions of consolidation or merger, the mode of carrying the same into effect, and stating such other facts required or permitted by the provisions of this chapter to be set out in certificates of incorporation, as can be stated in the case of a consolidation or merger, stated in such altered form as the circumstances of the case require, as well as the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation resulting from or surviving such consolidation or merger, with such other details and provisions as are deemed necessary. Any such agreement may provide for the payment of cash in lieu of the issuance of fractional shares of the resulting or surviving corporation." (Formerly part of Section 59 of the Delaware Corporation Law).

Sec. 252 Consolidation or merger of domestic and foreign corporations; service of process upon surviving corporation

"(a) Any one or more corporations organized under the provisions of this chapter, or existing under the laws of this State, may consolidate or merge with one or more other corporations organized under the laws of any other state or states of the United States, if the laws under which the other corporation or corporations are formed shall permit such consolidation or merger. The constituent corporations may merge into a single corporation, which may be any one of the constituent corporations, or they may consolidate to form a new corporation, which may be a corporation of the State of incorporation of any one of the con-

stituent corporations as shall be specified in the agreement required by subsection (b) of this section."

"(b) All the constituent corporations shall enter into an agreement in writing which shall prescribe the terms and conditions of the consolidation or merger, the mode of carrying the same into effect, the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation resulting from or surviving such consolidation or merger and such other details and provisions as shall be deemed necessary or proper. There shall also be set forth in the agreement such other facts as shall then be required to be set forth in certificates of incorporation by the laws of the state which are stated in the agreement to be the laws that shall govern the resulting or surviving corporation and that can be stated in the case of a consolidation or merger. Any such agreement may provide for the payment of cash in lieu of the issuance of fractional shares of the resulting or surviving corporation." (Formerly part of Section 59 of the Delaware Corporation Law).

Sec. 259. Status, rights, liabilities, etc., of constituent and surviving corporations following merger or consolidation

"(a) When an agreement of consolidation or merger shall have been signed, acknowledged, filed and recorded, in accordance with the requirements of this subchapter, or upon the effective date of the merger if otherwise stated in the certificate, for all purposes of the laws of this State the separate existence of all the constituent corporations, parties to said agreement, or of all such constituent corporations except the one into which the other or others of such constitutent corporations have been merged, as the case may be, shall cease and the constituent corporations shall become a new corporation, or be merged into one of such corporations, as the case may be, in accordance with the provisions of said agreement, possessing all the rights, privileges, powers and franchises as well of a public as of

a private nature and being subject to all the restrictions, disabilities and duties of each of such corporations so consolidated or merged; and all and singular, the rights, privileges, and all property, real, personal and mixed, including in the case of banks or trust companies, without any order or action on the part of any court or otherwise, appointments, designations, and nominations and all other rights and interests as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, trustee of estates of lunatics and in every other fiduciary capacity, and all debts due to any of said constitutent corporations on whatever account, as well for stock subscriptions as all other things in action or belonging to each of such corporations shall be vested in the corporation resulting from or surviving such consolidation or merger; and all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the resulting or surviving corporation as they were of the several and respective constituent corporations, and the title to any real estate vested by deed or otherwise, under the laws of this State, in any of such constituent corporations, shall not revert or be in any way impaired by reason of this chapter; but all rights of creditors and all liens upon any property of any of said constituent corporations shall be preserved unimpaired, and all debts, liabilities and duties of the respective constituent corporations shall thenceforth attach to said resulting or surviving corporation, and may be enforced against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it." (Formerly Section 60(a) of the Delaware Corporation Law).

Sec. 261. Effect of consolidation or merger upon pending actions

"Any action or proceeding pending by or against any of the corporations consolidated or merged may be prosecuted as if such consolidation or merger had not taken place, or the corporation resulting from or surviving such consolidation or merger may be substituted in its place."

Extracts From "Agreement of Merger Among Consumers Company, Frontier Chemical Company and Follansbee Steel Corporation, Dated: As of September 13, 1954" (Exhibit B to Proxy Statement).

SECTION 1

"Subject to the conditions in Section 11 and elsewhere herein set forth, as soon as this Agreement of Merger shall have been approved by the votes of holders of the capital stock of Consumers, Frontier, and Follansbee, in accordance with the requirements Title 8 of the Delaware Code of 1953 and such facts shall have been certified by the Secretary or Assistant Secretary of each of said Corporations under their respective corporate seals and this Agreement of Merger so certified shall have been signed, acknowledged, filed and recorded, all as required by the provisions of Section 251 of the Delaware Code of 1953, thereupon said three corporations shall become a single corporation, to-wit: Follansbee, which shall survive the merger. The date upon which Consumers and Frontier shall be so merged into Follansbee is hereinafter referred to as 'the effective date of this Agreement of Merger,' and the single corporation, Follansbee, which shall survive the merger, is sometimes hereinafter called the 'Surviving Corporation.'"

SECTION 2

"Except as hereinafter otherwise specifically set forth, Follansbee, the Surviving Corporation, its identity, existence, purposes, powers, objects, franchises, rights and immunities shall continue unaffected and unimpaired by the merger, and the corporate franchises, entity, existence and rights of Consumers and Frontier shall be merged into Follansbee, and Follansbee shall be fully vested therewith on and after the effective date of this Agreement of Merger. The separate existence of Consumers and Frontier, except as it may be continued by statute, shall cease, and Consumers and Frontier shall be merged into Follansbee in accordance with the provisions of this Agreement of Merger."

Relevant Portions of Illinois Law Effective in 1937 Through 1954.

"157.102. § 102. *Admission of Foreign Corporation.* A foreign corporation organized for profit, before it transacts business in this State, shall procure a certificate of authority so to do from the Secretary of State. A foreign corporation organized for profit, upon complying with the provisions of this Act, may secure from the Secretary of State a certificate of authority to transact business in this State, but no foreign corporation shall be entitled to procure a certificate of authority under this Act to transact in this State the business of banking, insurance, suretyship, or a business of the character of a building and loan corporation. A foreign corporation shall not be denied a certificate of authority by reason of the fact that the laws of the state under which such corporation is organized governing its organization and internal affairs differ from the laws of this State, and nothing in this Act contained shall be construed to authorize this State to regulate the organization or the internal affairs of such corporation.

"157.106. § 106. *Application for certificate of authority.* A foreign corporation, in order to procure a certificate of authority to transact business in this State, shall make application therefor to the Secretary of State, which application shall set forth:

> "(a) The name of the corporation and the state or country under the laws of which it is organized . . .

"157.135. § 135. *License fees payable by foreign corporations.* The Secretary of State shall charge and collect from each foreign corporation authorized to transact business in this State the following license fees, computed on the basis and at the rates prescribed in this Act:

> "(a) An initial license fee at the time of filing its application for a certificate of authority to transact business in this State. . . .

"157.136. § 136. *Basis of computation of license fees payable by foreign corporations.* The basis for the initial license fee payable by a foreign corporation shall be the amount represented in this State, determined in accordance with the provisions of this section, of the sum of its stated capital and paid-in surplus. . . .

"157.137. § 137. *Rate of license fees payable by foreign corporations.* The initial license fee and all additional license fees payable by a foreign corporation shall be computed at the rate of one-twentieth of one per cent of the basis prescribed in this Act for the computation of the initial license fee and additional license fees, respectively.

Relevant Portions of Internal Revenue Code of 1954.

68A Stat. 18

"Sec. 63. Taxable Income Defined.

"(a) *General Rule.*—Except as provided in subsection (b), for purposes of this subtitle the term 'taxable income' means gross income, minus the deductions allowed by this chapter, other than the standard deductions allowed by part IV (sec. 141 and following).

68A Stat. 45

"Sec. 161. Allowance of Deductions.

"In computing taxable income under section 63(a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible).

"Sec. 165.

"(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

"(b) *Amount of Deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction

for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property. . . ."

68A Stat. 63

"Sec. 172. Net Operating Loss Deduction.

"(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.

. . .

"(c) *Net Operating Loss Defined.*—For purposes of this section, the term 'net operating loss' means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

"(d) *Modifications.*—The modifications referred to in this section are as follows:

. . .

"(4) *Nonbusiness deductions of taxpayers other than corporations.*—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

"(A) Any gain or loss from the sale or other disposition of—

"(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

"(ii) real property used in the trade or business, shall be treated as attributable to the trade or business; . . .

68A Stat. 80

"Sec. 269. Acquisitions made to Evade or Avoid Income Tax.

"(a) *In General.*—If—

"(1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or

"(2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation.

and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then the Secretary or his delegate may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

. . .

"(c) *Presumption in Case of Disproportionate Purchase Price.*—The fact that the consideration paid upon an acquisition by any person or corporation described in subsection (a) is substantially disproportionate to the aggregate—

"(1) of the adjusted basis of the property of the corporation (to the extent attributable to the interest

acquired specified in paragraph (1) of subsection (a), or of the property acquired specified in paragraph (2) of subsection (a); and

"(2) of the tax benefits (to the extent not reflected in the adjusted basis of the property) not available to such person or corporation otherwise than as a result of such acquisition.

shall be prima facie evidence of the principal purpose of evasion or avoidance of the Federal income tax. This subsection shall apply only with respect to acquisitions after March 1, 1954.

68A Stat. 124

"Sec. 381. (a) GENERAL RULE.—In the case of the acquisition of assets of a corporation by another corporation—

"(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b)(2); or

"(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368 (a)(1),

"the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

. . .

"(c) Items of the Distributor or Transferor Corporation.—The items referred to in subsection (a) are:

"(1) Net Operating Loss Carryovers.—The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

"(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer. . . .

68A Stat. 129

"Sec. 382. (a) Purchase of a Corporation and Change in its Trade or Business.—

"(1) In General.—If at the end of a taxable year of a corporation—

"(A) Any one or more of those persons described in paragraph (2) own a percentage of the total fair market value of the outstanding stock of such corporation which is at least 50 percentage points more than such person or persons owned at—

"(i) the beginning of such taxable year, or

"(ii) the beginning of the prior taxable year,

"(B) the increase in percentage points at the end of such taxable year is attributable to—

"(i) a purchase by such person or persons of such stock, the stock of another corporation owning stock in such corporation, or an interest in a partnership or trust owning stock in such corporation, or

"(ii) a decrease in the amount of such stock outstanding or the amount of stock outstanding of another corporation owning stock in such corpora-

tion, except a decrease resulting from a redemption to pay death taxes to which section 303 applies, and

"(C) such corporation has not continued to carry on a trade or business substantially the same as that conducted before any change in the percentage ownership of the fair market value of such stock,

"the net operating loss carryovers, if any, from prior taxable years of such corporation to such taxable year and subsequent taxable years shall not be included in the net operating loss deduction for such taxable year and subsequent taxable years.

"(2) Description Person or Persons.—The person or persons referred to in paragraph (1) shall be the 10 persons (or such lesser number as there are persons owning the outstanding stock at the end of such taxable year) who own the greatest percentage of the fair market value of such stock at the end of such taxable year; except that, if any other person owns the same percentage of such stock at such time as is owned by one of the 10 persons, such person shall also be included. If any of the persons are so related that such stock owned by one is attributed to the other under the rules specified in paragraph (3), such persons shall be considered as only one person solely for the purpose of selecting the 10 persons (more or less) who own the greatest percentage of the fair market value of such outstanding stock.

"(3) Attribution of Ownership.—Section 318 (relating to constructive ownership of stock) shall apply in determining the ownership of stock, except that sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein.

"(4) Definition of Purchase.—For the purposes of this subsection the term 'purchase' means the acquisi-

tion of stock, the basis of which is determined solely by reference to its cost to the holder thereof, in a transaction from a person or persons other than the person or persons the ownership of whose stock would be attributed to the holder by application of paragraph (3).

"(b) Change of Ownership as the result of a Reorganization.—

"(1) In General.—If, in the case of a reorganization specified in paragraph (2) of section 381(a), the transferor corporation or the acquiring corporation—

"(A) has a net operating loss which is a net operating loss carryover to the first taxable year of the acquiring corporation ending after the date of transfer, and

"(B) the stockholders (immediately before the reorganization) of such corporation (hereinafter in this subsection referred to as the 'loss corporation'), as the result of owning stock of the loss corporation, own (immediately after the reorganization) less than 20 percent of the fair market value of the outstanding stock of the acquiring corporation,

the total net operating loss carryover from prior taxable years of the loss corporation to the first taxable year of the acquiring corporation ending after the date of transfer shall be reduced by the percentage determined under paragraph (2).

"(2) Reduction of Net Operating Loss Carryover.—The reduction applicable under paragraph (1) shall be the percentage determined by subtracting from 100 percent—

"(A) the percent of the fair market value of the outstanding stock of the acquiring corporation owned (immediately after the reorganization) by

the stockholders (immediately before the reorganization) of the loss corporation, as the result of owning stock of the loss corporation, multiplied by

"(B) five.

"(3) Exception to Limitation in this Subsection.—The limitation in this subsection shall not apply if the transferor corporation and the acquiring corporation are owned substantially by the same persons in the same proportion. . . .

"(6) Stock of Corporation Controlling Acquiring Corporation.—If the stockholders of the loss corporation (immediately before the reorganization) own, as a result of the reorganization, stock in a corporation controlling the acquiring corporation, such stock of the controlling corporation shall, for purposes of this subsection, be treated as stock of the acquiring corporation in an amount valued at an equivalent fair market value.

"(c) Definition of Stock.—For purposes of this section, 'stock' means all shares except nonvoting stock which is limited and preferred as to dividends."

Technical Information Release No. 773. By Commission October 13, 1965.

The United States Internal Service today announced that it will not follow the decision of the United States Court of Appeals for the Ninth Circuit in the case of *Maxwell Hardware Co.* v. *Commissioner,* 343 F.2d 713 (1965).

In that case, the circuit court held that the Supreme Court's decision in *Libson Shops, Inc.* v. *Koehler,* 353 U.S. 382 (1957), has no precedential value under the 1954 Code, and that the net operating loss carryovers involved therein were not subject to disallowance under section 172, 269 or 382. The court, by way of dictum, stated that the Com-

misioner might have successfully applied section 482 in this case.

It is the position of the Revenue Service that in cases similar to *Maxwell Hardware,* sections 269 and 382, as well as section 482, are applicable in dealing with the carryover of losses. The Revenue Service believes that the foregoing statutory provisions must be construed to effectuate congressional intent in combating "trafficking in loss carryovers." Moreover, the Service also believes that the loss carryover in cases similar to *Maxwell Hardware* should be denied under the rationale of the *Libson Shops* decision since to permit a loss carryover in such cases would run counter to the legislative objectives of the carryover privilege.

The cornerstone of the *Libson Shops* decision was a searching examination of the purposes of the carryover privilege. Thus, in approaching the question of whether the taxpayer was entitled to a loss carryover, the Supreme Court held that the loss carryover provision was not automatic and that the "availability of . . . [the loss carryover] privilege depends on the proper interpretation to be given to the carryover provisions." The Service believes that this fundamental type of statutory analysis was not made obsolete by the enactment in 1954 of provisions limiting or denying loss carryovers in certain situations involving abuses that were specifically brought to the attention of Congress. It is the view of the Service that the basic approach of the Supreme Court in *Libson Shops* retains vitality under the 1954 Code in interpreting the application of section 172.

Accordingly, the Service will apply *Libson Shops* in any loss carryover case under the 1954 Code, not contemplated by the announcement in Revenue Ruling 58-603, C.B. 1958-2, 147, where there has been both a 50 percent or more shift in the benefits of a loss carryover (whether direct or indirect and including transactions having the

effect of shifting the benefit of the loss by shifting assets, stock, profit interests or other valuable rights) and a change in business as defined in section 382(a) and the regulations thereunder. The Service will not rely on *Libson Shops* under the 1954 Code in any loss carryover case where there has been less than a 50 percent change in the beneficial ownership of the loss or where there has been no change in business as defined in section 382(a) and the regulations thereunder. However, the Service will continue to rely on sections 269 and 482, where appropriate, in dealing with the carryover of losses. Revenue Ruling 63-40, C.B. 1963-1, 46 will be modified to the extent inconsistent herewith.

The Revenue Service stated that certiorari was not requested in *Maxwell Hardware* due to the absence of a direct conflict between the circuits. The decision will not be followed as a precedent in the disposition of similar cases.

(Copied from 1965 Commerce Clearing House Income Tax Service, ¶ 6751)

Item 1—Extract from House and Senate Committee Reports on § 172 of the 1954 Code:

> "A further substantive change will permit taxpayers other than corporations who sell a business or certain business assets in effect to include any loss sustained on the sale of such business or business assets as part of a net operating loss for the year of the sale (Corporations are entitled to this treatment under present law and under this section). Thus, subsection (d)(4)(A) will overrule the decision in Joseph Sic. v. Commissioner (10 T.C. 1096, 177 F.2d 649 (CA-8), certiorari denied, 339 U.S. 913, 70 S.Ct. 572), and similar cases, which held, for example, that a farmer who sold his farm at a loss could not include such loss as part of his net operating loss. The cases indicated

that such loss was a nonbusiness loss since the taxpayer was not in the business of selling farms. The new provisions will reach the opposite result." (U.S. Cong. & Admin. News 1954, pp. 4193, 48-49)

Item 2—Extract from House Committee Report on § 381 of the 1954 Code:

"*D. Carryover to successor corporations (sec. 381)* Present law makes no provision for the transfer from one corporation to another in a tax-free merger or consolidation, of the major tax benefits, privileges, elective rights and obligations which were available to the predecessor. These include such items as loss carryover, unamortized bond discount, installment sales reporting, LIFO inventory method, etc. The courts have held, in general, that such tax attributes of a corporation may be preserved *only by continuing the corporation's identity.* For example, *the surviving corporation in a merger is generally entitled only to the tax attributed from its own premerger experience and not from the experience of the other corporations merged.* More recently, however, this separate entity rule appears not to have been followed.

"As a result, present practice rests on courtmade law which is uncertain and frequently contradictory. *Moreover, whether or not the carryover is allowed should be based upon economic realities rather than upon such artificialities as the legal form of the reorganization.*

. . . . . .

"The new rules enable the successor corporation *to step into* the *'tax shoes' of its predecessor* corporation without necessarily conforming to artificial legal requirements which now exist under court-made law. . . ." (U.S. Cong. & Admin. News 1954, pp. 4066-7, emphasis supplied)

Item 3(a) Extract from Senate Committee Report on § 122 of the Revenue Act of 1943 Respecting § 120 of the 1939 Code:

"The objective of the section, as stated in the report on the House bill, is to prevent the distortion through tax avoidance of the deduction, credit, or allowance provisions of the Code, particularly those of the type represented by the recently developed practice of corporations with large excess profits (or the interests controlling such corporations) acquiring corporations with current, past, or prospective losses or deductions, deficits, or current or unused excess profits credits, for the purpose of reducing income and excess profits taxes. (1944 Cum. Bul. 1016)

. . . . . .

"Your committee recognizes these facts and is in agreement with these objectives. Your committee also recognizes the difficulty of formulating a proper general provision which will be helpful in administration and decision in distinguishing between business conduct which effectuates the basic purposes of the deduction, credit, and allowance provisions of the Code and arrangements which distort, pervert, and defeat such basic purposes. (1944 Cum. Bul. 1016)

. . . . . .

". . . To determine what transactions constitute the condemned evasion or avoidance, section 129 must be read in its context and background. It is superimposed on the several existing provisions of the income and excess profits tax law, the basic policies of which contemplate the bona fide conduct of business in the ordinary way. Basic to the deduction, credit, and allowance provisions is a continuing enterprise so conducting its affairs. A substantial number of the Code provisions, like sections 112, 113, and 141, are especially designed to remove tax impediments from such business transactions. It is nonconfirmity to the basic policies of these provisions of the Code which is

denoted by tax avoidance in section 129, and it is in the light of these basic policies that section 129 would necessarily have to be applied and administered. Such is also the case under section 45 and under the principles applied in the absence of the explicit statutory language. The National securities and Spreckles cases cited above aptly illustrate such nonconformity, violating in those cases the basic policies of the deduction provisions, and in the Spreckles case, the consolidated returns provisions. The test of this nonconformity is, as was indicated in *Higgins* v. *Smith*, whether the transaction or a particular factor thereof 'distorts the liability of the particular taxpayer' when the 'essential nature' of the transaction or factor is examined in the light of the 'legislative plan' which the deduction or credit is intended to effectuate. (1944 Cum. Bul. 1017)

Item 3(b) Extract from Conference Report on the Revenue Act of 1943 Respecting § 129 of the 1939 Code:

"Under the conference agreement, the categories of tax evasion and tax avoidance selected for specific treatment under section 129 are those characterized either by the acquisition of control of a corporation, or by the acquisition of property (with a transferred basis) by one corporation from another not controlled immediately prior to such acquisition by such first corporation. . . ." (1944 CB 1069.)

Item 4 Extract from House and Senate Committee Reports on the 1954 Code Respecting § 269(c):

". . . This provision will apply to cases where the *tax basis* of the property *acquired* for depreciation and other purposes, together with the tax value of other tax benefits, such as operating loss carryovers, is *substantially greater* than the *amount paid* for the property. Disparities of this type generally arise where the *old basis* is continued in the hands of the new owner." (U.S. Cong. & Admin. News 1954, pp. 4057, 4670, emphasis supplied)

Certain Specific Organization Expenses of Consumers

In the following part of the stipulation in both Nos. 30,116 and 30,117, Consumers Company is called "Delaware" and its predecessor, an Illinois corporation, is called "Illinois." It was stipulated that during the period from June 19, 1934, until February 28, 1938, "Illinois and Delaware incurred and paid the following organization and reorganization expenses to the persons or firms listed in respect of the services described: . . .

"(m) Halsey, Stuart & Co., Inc. $14,592.90

"The Court ordered Delaware to pay Halsey, Stuart & Co., Inc. reasonable compensation for services rendered and to be rendered as Exchange Agent in making the payments of cash and effecting the exchange of securities of Delaware as requird by the Substitute Plan of Reorganization and the Court decree confirming said Plan.

"(n) Continental Illinois National Bank $10,029.45

"Continental Illinois National Bank and Trust Company of Chicago acted as the transfer agent of Delaware and of the trustees of the stock trust created under the Substitute Plan of Reorganization.

"(o) Chicago Stock Exchange $3,000.00

"The amount listed was paid to the Chicago Stock Exchange (predecessor to the Midwest Stock Exchange) by Delaware during 1937 to cover listing fees for various securities issued by the Company.

"(p) Secretary of State of Illinois $3,209.34

"The amount listed was paid to the Secretary of State of Illinois for for various services including fees for minis-

terial and recording services required under applicable state laws of Illinois.

"(q) Security Banknote Company $3,564.25

"(r) Security Banknote Company $3,564.25

"This amount was paid to Security Bank Note Company by Illinois and Delaware for the printing of new certificates evidencing ownership of securities issued by the reorganized company."

Evidence Respecting Erroneous Findings of Fact by the Court of Appeals

In the discussion of the statutory provison that the "principle purpose" shall be "the evasion or avoidance of Federal income tax," the Court of Appeals concluded, in effect, that there was no proof of association between the sale of assets and the precise merger, and made other comments about the absence of evidence which might have been persuasive to show that tax avoidance was not the principle purpose of the merger, pp. 16a-20a. There is a specific statement that Follansbee had converted its assets to cash at some point before the stockholders' meeting, p. 18a.

That statement, and the foregoing implications of other statements in the opinion, are plainly erroneous. This is shown by the notice of the call of the special meeting of the stockholders of Follansbee to be held on October 27, 1954, given by order of the Board of Directors dated October 4, 1954, and in the Proxy Statement attached thereto. The items of business to be transacted were described in the notice as follows:

"1. 'The adoption or rejection of' a Purchase Contract dated August 2, 1954, and amended September 22, 1954, of

which a copy was attached as Exhibit A to the Proxy Statement.

"2. 'The adoption or rejection *(subject to the adoption of the Purchase Contract)* of a certain Agreement of Merger dated September 15, 1954,' a copy of which was attached as Exhibit B to the Proxy Statement. This agreement provided for the merger of Consumers and Frontier into Follansbee described on page 4 and for the change of Follansbee's name to Union Chemical. Parts of this agreement are copied on p. 28a.

"3. Any other business that might properly come before the meeting." (Emphasis supplied)

It was stipulated that the contents of the Proxy Statement and other material should constitute evidence in No. 30,117 without further proof. The Proxy Statement contains specific assertions that the merger was conditioned, and dependent, upon consummation of the sale of the Follansbee assets, pursuant to the Purchase Contract. No specific relief is sought in this Court in reliance on these additional facts. They are stated, primarily, to show that the Court of Appeals proceeded upon an erroneous view of the facts as to the relationship between the Purchase Contract and the merger, and that the decision is not necessarily based on a question of fact.

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No. 71-414

In the Supreme Court of the United States

OCTOBER TERM, 1971

VULCAN MATERIALS COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court is reported at 308 F. Supp. 53. The opinion of the court of appeals (Pet. App. 3a–20a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on May 28, 1971 (Pet. App. 1a). A petition for rehearing was denied on June 25, 1971 (Pet. App. 2a). The petition for a writ of certiorari was filed on September 22, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether organization and reorganization expenses incurred by petitioner's predecessors, and

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admittedly capital in nature and nondeductible when incurred, became deductible upon the occurrence of subsequent corporate mergers.

2. Whether one of petitioner's predecessors acquired two other corporations for the principal purpose of tax avoidance, so that the former's net operating loss carryovers were properly disallowed under Section 269(a)(2) of the Internal Revenue Code of 1954.

STATUTE INVOLVED

The pertinent provisions of Section 269 of the Internal Revenue Code of 1954 are set forth in the Appendix to the petition (p. 32a).

STATEMENT

In December, 1954, Consumers Company (Consumers) and Frontier Chemical Company (Frontier), both Delaware corporations, were merged into a third Delaware corporation, Follansbee Steel Corporation (Follansbee). Prior to this merger, Follansbee disposed of all of its operating assets. At the time of the merger, Follansbee owned approximately nine million dollars in liquid assets and had an unused net operating loss carryover of approximately six million dollars. In the merger proceedings, the name of the surviving corporation was changed from Follansbee Steel Corporation to Union Chemical and Material Corporation (Union Chemical). Three years later, in December, 1957, Union Chemical merged into Vulcan Materials, a New Jersey corporation, petitioner here. Each of these mergers constituted reorganizations within the meaning of Section 368(a)(1)(A) of the Internal Revenue Code of 1954. (Pet. App. 4a.)

Between 1934 and 1946, predecessors of petitioner incurred various organization and reorganization expenses, all of which are conceded to be capital in nature and thus not deductable when paid or incurred. Union Chemical deducted these expenses on its 1957 income tax return. The Commissioner disallowed the deductions on the ground that the expenses remained capital in nature and, therefore, were not deductible upon merger. (Pet. App. 4a.)

The Commissioner also determined, pursuant to Section 269(a) of the Internal Revenue Code, that Union Chemical was not entitled to carryover and deduct on its 1957 return Follansbee's pre-merger (1954) net operating loss. This determination was premised on the Commissioner's finding that Follansbee's acquisition of Consumers and Frontier was for the principal purpose of enabling Follansbee to use its net operating loss carryforward to reduce the income generated by the businesses of Consumers and Frontier, which were continued by the surviving corporation after the merger. (Pet. App. 5a.)

These suits for refund followed. The district court sustained the Commissioner's determinations, and the court of appeals affirmed (Pet. App. 3a–20a).

ARGUMENT

The decision below is correct. There is no conflict of decisions or other reason for further review.

A. THE ORGANIZATION EXPENSE ISSUE

1. It is settled that organization and reorganization expenses, which result in the acquisition of an asset

having an indefinite useful life, are capital in nature and not deductible when paid or incurred. See, *e.g.*, *General Bancshares Corp.* v. *Commissioner*, 326 F. 2d 712 (C.A. 8), certiorari denied, 379 U.S. 832; *Godfrey* v. *Commissioner*, 335 F. 2d 82, 85 (C.A. 6), certiorari denied, 379 U.S. 966. It is likewise settled that upon the dissolution and liquidation of a corporation, capital expenditures previously incurred—but not deducted—become deductible, since they no longer have any value to the business. See, *e.g.*, *Bryant Heater Co.* v. *Commissioner*, 231 F. 2d 938 (C.A. 6); *Koppers Co.* v. *United States*, 278 F. 2d 946 (Ct. Cl.). But this latter rule has uniformly been held inapplicable in a merger, where the rights, franchises, and privileges acquired as a result of previous organization expenditures continue to be enjoyed by the surviving corporation. See, *e.g.*, *Citizens Trust Co.* v. *Commissioner*, 20 B.T.A. 392; *Motion Picture Capital Corp* v. *Commissioner*, 32 B.T.A. 339; *Addressograph-Multigraph Corp.* v. *Commissioner*, P–H Memo T.C., par. 45,058.

Contrary to petitioner's claim (Pet. 21–23), it is immaterial whether the constituent corporations in a merger were organized in different states or the same state. In either event, the surviving corporation enjoys to a similar degree and extent as its predecessors the benefits which resulted from their organization and reorganization expenditures.

2. There is no conflict, even in principle, with *Marr* v. *United States*, 268 U.S. 536, which involved a wholly different issue. The Court there concluded that the shareholders' stock interest following the dissolution of a New Jersey corporation and the emergence of a

Delaware corporation was substantially different from what it had been prior to the dissolution. The instant case lacks both a dissolution and facts to suggest that any valuable interest held prior to the merger was lost upon the occurrence of the merger. Moreover, *Marr* involved a taxable year prior to the enactment of the reorganization provisions of the Code whose basic concept is that the surviving corporation in a tax-free reorganization continues the businesses of the predecessor corporations. As for the cases involving the now repealed documentary stamp tax, upon which petitioner also relies (Pet. 22–24), it is enough to point out that they deal with the unrelated problem of the application of the stamp tax to the documents evidencing the termination of the acquired corporation's entity, and not with the question whether that corporation's business is carried on by the surviving corporation.

B. SECTION 269 ISSUE

1. Section 269(a)(2) of the Internal Revenue Code provides that if one corporation acquires property of another previously uncontrolled corporation for the principal purpose of avoiding income taxes by obtaining the benefit of a deduction that would otherwise have been unavailable, the deduction shall be disallowed. Here, in 1954, Follansbee acquired property from previously uncontrolled corporations, Consumers and Frontier, and after the acquisitions, Follansbee's stockholders owned 57 percent of the stock of the surviving corporation, Union Chemical. This satisfies the 50 percent control requirement under Section 269(a). And both courts below found that the principal pur-

pose of Follansbee's acquisitions was to permit it to offset its net operating loss carryover against the post-merger profits generated by the acquired corporations' businesses.

2. It is settled that the proscription of Section 269 applies where, as here, the acquiring corporation is the loss corporation, as well as in cases where the loss corporation is the acquired corporation, so long as the principal purpose of the acquisition was tax avoidance. See, *e.g., Southland Corp.* v. *Campbell,* 358 F. 2d 333 (C.A. 5); *Ach* v. *Commissioner,* 358 F. 2d 342 (C.A. 6). There is no basis for petitioner's claim to the contrary. Nor is there any conflict with *Maxwell Hardware Co.* v. *Commissioner,* 343 F. 2d 713 (C.A. 9). In that case, unlike this one, it was found that the acquiring parties did not obtain the requisite 50 percent control and, therefore, that Section 269 was inapplicable.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Acting Assistant Attorney General.

ELMER J. KELSEY,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-414

VULCAN MATERIALS COMPANY, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR REHEARING OF THE ORDER DENYING THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR REHEARING OF THE ORDER DENYING THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Now comes Vulcan Materials Company, petitioner in the above styled proceeding, and petitions for a rehearing of the order denying the petition for a writ of certiorari entered on November 9, 1971, and in support thereof, respectfully shows the following unto the Court:

1. Because of the promulgation of Technical Information Release 773 by the Commissioner of Internal Revenue on, to-wit, October 13, 1965, it is improbable that there will here-

after be a conflict in decision on the denial of the net operating loss carryover based on the provisions of Section 269 of the 1954 Code, although the decision of the Court of Appeals is urged to be incorrect and relates to an important question of federal law which has not been, but should be, settled by this Court.

The petition did not present the foregoing as a ground for granting the writ because of the contention therein that the decision of the Court of Appeals below was in conflict with the decision in *Maxwell Hardware Co.* v. *Commissioner,* 343 F.2d 713 (9 Cir., 1964). In its brief in opposition, the United States has asserted that there was no conflict, on predicates we deem to be erroneous. However, if we are mistaken in this contention, then it is improbable that any other decision will be hereafter rendered which is in conflict with the decision below.

This results from a declaration of policy by the Commissioner of Internal Revenue made in a Technical Information Release on October 13, 1965 and unofficially reported in ¶ 6751 of the Commerce Clearing House income tax service for that year. The release is copied in the appendix to the petition, pages 37a-39a. The part of that release which is relevant to the petition reads:

> "The Service will not rely on *Libson Shops* under the 1954 Code in any loss carryover case where there has been less than a 50 percent change in the beneficial ownership of the loss or where there has been no change in business as defined in section 382(a) and the regulations thereunder. However, the Service will continue to rely on sections 269 and 482, where appropriate, in dealing with the carryover of losses. Revenue Ruling 63-40, C.B. 1963-1, 46 will be modified to the extent inconsistent herewith."

This extract from TIR 773 is copied in the opinion of the Court of Appeals (p. 15a), and that Court expresses disagreement therewith. However, consideration of the extract, in the context of the entire release, effectively demonstrates that it is improbable that the Commissioner will deny a net operating loss carryover in any case in which there is a change of less than 50% in the beneficial ownership of the loss.

In the case at bar, the Court of Appeals undertook to distinguish its own decision in *U. S.* v. *Jackson Oldsmobile, Inc.,* 371 F.2d 808 (5 Cir., 1967) on the theory that there had not been any change in business (p. 14a). However, that was not the ground on which the affirmance was placed by the Court of Appeals, and the concurring opinion therein contained a basic reference to TIR 773 as follows:

> "The Trial Judge was therefore correct in concluding that GM, as owner of 60% of the stock, received the majority benefit from the carryover deductions. The benefit was in the form of dividends and appreciation in the value of the stock. Cf. TIR 773." (371 F.2d 809)

As to the actual existence of a conflict between the decisions of the Courts of Appeals herein and in *Maxwell Hardware,* the brief in opposition contains certain statements, or implications, which Vulcan urges are confusing and may create an erroneous impression as to the facts. This brief contains the following two sentences:

> "Here, in 1954, Follansbee acquired property from previously uncontrolled corporations, Consumers and Frontier, and after the acquisitions, Follansbee's stockholders owned 57 percent of the stock

> of the surviving corporation, Union Chemical. This satisfies the 50 percent control requirement under Section 269(a)." (Page 5)

The assertion in the second sentence is, in its context, not relevant to any issue except on the predicate that Union Chemical was a separate corporation from Follansbee. That this is the probable meaning of that sentence is indicated by the later claim that there is no conflict with *Maxwell Hardware,* in these terms:

> "In that case, unlike this one, it was found that the acquiring parties did not obtain the requisite 50% control and, therefore, that Section 269 was inapplicable." (Page 6)

The fact is that Follansbee, the surviving corporation, is identical with Union Chemical, since there was only a change in name in the merger proceedings. This is stated expressly on page 2 of the brief in opposition. In the case at bar, the persons who, for the first time, acquired stock in that surviving corporation, namely stockholders of Consumers and Frontier, did not acquire as much as 50% of either the common stock or of the fair market value of all outstanding stock.

The possible implication of the sentence last quoted that stockholders of Follansbee were "acquiring parties" within the contemplation of Section 269(a) is plainly erroneous. What they did was to *retain* more common stock than was issued to the stockholders of Frontier and Consumers and also to receive preferred stock as a means of compensating them for the value of the net loss carryover.

There is the same occasion for granting the writ on the net operating loss issue as there was in the

case of *Libson Shops* v. *Koehler,* 353 U.S. 382 (1957), since the net loss carryover provisions of the 1954 Code need clarification as much as did those of the 1939 Code.

2. Because of the acquiescence by the Commissioner of Internal Revenue in Kingsford Company v. Commissioner, 41 T.C. 646, and the attitude of the United States in cases like Bryant Heater Company v. Commissioner, 231 F.2d 938, it is improbable that there will be a conflict on the organization and reorganization expense issue in the case of any non-taxable reorganization except a merger, though it involves important recurring questions of law respecting the deductibility thereof which have not been, but should be, decided by this Court.

Notwithstanding the concession made by the United States with respect to the decision in *Bryant Heater Co.* v. *Commissioner,* 231 F.2d 938 (6 Cir., 1956), *Koppers Company, Inc.* v. *United States,* 278 F.2d 946 (Ct. Cl. 1960) and others and the acquiescence of the Commissioner in *Kingsford Company* v. *Commissioner,* 41 TC 646 (1964) reported at 1964-2 C.B. 6, the brief in opposition appears to raise the issue that the deduction should be denied in merger cases because "the surviving corporation in a tax-free reorganization continues the businesses of the predecessor corporations." (p. 5)

This statement is made in the effort to distinguish the decision in *Marr* v. *U. S.,* 268 U.S. 536 (1925) which we urge is in conflict with the decision of the Court of Appeals in the case at bar. We construe that statement to involve an argument which was first raised in the brief in opposition within the contemplation of paragraph 4 of Rule 24. The denial of the petition for the writ came before we filed any reply.

That the non-taxability of the transaction at the corporate, or stockholder, level is not material with

respect to the deductibility of organization and reorganization expenses on the dissolution and liquidation of a corporation was expressly held in *Kingsford Company, Bryant Heater,* and *Koppers Co., Inc.* A like result was reached in other decisions favorable to the taxpayer, but this particular issue was not raised therein. Of those cases, only *Kingsford Company* involves the reorganization provisions of the various statutes.

That question can arise in a "C" type reorganization such as was involved in *Kingsford Company* or in a "B" type reorganization if the corporation whose stock is acquired is thereafter dissolved and liquidated. But in view of the acquiescence of the Commissioner in *Kingsford Company* and of the position of the United States with respect to *Bryant Heater* and like cases, it is improbable that the issue will be presented hereafter in any case which will conflict with the decision of the Court of Appeals in the case at bar. Yet, the status of the deductibility of such expenditures in the case of a merger is an important recurring question which, we submit, should be decided by this Court.

There is one statement in the brief in opposition on this question which appears to be incorrect. We have noted the assertion that there is no conflict of decision. The brief in opposition after making that contention, and stating the rule respecting the deductibility of organization expenses upon the dissolution and liquidation of a corporation, proceeds with the assertion that this rule has "uniformly" been held inapplicable in a merger. This statement is supported by the citation of *Citizens Trust Company* v. *Commissioner,* 20 B.T.A. 392 (1930), and other decisions of that tribunal.

In the use of the word "uniformly," the brief in opposition ignores the decision in *Dragon Cement Company* v. *U. S.*, 144 F.Supp. 188 (D.C., Maine, 1956). On this issue, *Dragon Cement* is in direct conflict with the decision in *Citizens Trust*. The District Judge there specifically stated his disagreement with the Government's contention that there is a "distinction between termination by dissolution and by merger." (144 F.Supp. 191)

The Government did not appeal from that adverse decision, although the taxpayer did appeal. This issue was recognized by the Court of Appeals in *Dragon Cement Company* v. *U. S.*, 244 F.2d 513, 514 (1 Cir. 1957) as one which was no longer in the case.[1]

WHEREFORE, the petitioner respectfully prays that the order denying the petition for a writ of certiorari be vacated and an order granting the petition with respect to each of the issues be granted.

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[1] The statement in the petition that it was the Government which appealed on the other issue is in error.

Certificate

This petition is based on grounds available to petitioner but not previously presented, *i.e.,* that it is improbable that there will be a conflict in other litigation, e.g., *Scribner-Schroth Co.* v. *Cleveland Trust Co.,* 305 U.S. 47, 50. Accordingly, Edward M. Selfe, attorney for the petitioner herein, hereby certifies that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in paragraph 2 of Supreme Court Rule 58.

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